MILESTONE SCIENTIFIC INC.
Form 10-K
March 13, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2013

or

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 001-14053

Milestone Scientific Inc.

(Exact name of registrant as specified in its charter)

Delaware	13-3545623
State or other jurisdiction of Incorporation or organization	(I.R.S. Employer Identification No.)

220 South Orange Avenue, Livingston, NJ 07039

(Address of principal executive offices)

Registrant's telephone number, including area code 973-535-2717

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

Securities registered pursuant to section 12(g) of the Act: Common Stock, par value $.001 per share

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes þ No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, 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). þ Yes ¨ No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K. R

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 the 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 ¨ (Do not check if a smaller reporting company)	Smaller reporting company þ

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

As of June 28, 2013, the last business day of Milestone's most recently completed second fiscal quarter, the aggregate market value of the common stock held by non – affiliates of the issuer was $15,303,014. This amount is based on the closing price of $1.35 per share of Milestone's common stock as of such date, as reported on the OTCQB.

As of March 12, 2014 the registrant has a total of 17,780,465 shares of Common Stock, $0.001 par value outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

MILESTONE SCIENTIFIC INC.

Form 10-K Annual Report

TABLE OF CONTENTS

PART I		
Item 1.	Description of Business	3
Item 1A.	Risk Factors	11
Item 1B.	Unresolved Staff Comments	13
Item 2.	Description of Property	13
Item 3.	Legal Proceedings	14
Item 4.	Mine Safety Disclosure	14
PART II		
Item 5.	Market for Common Equity, Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities	15
Item 6.	Selected Financial Data	15
Item 7.	Management's Discussion and Analysis or Plan of Operations	15
Item 7A.	Quantitative and Qualitative Disclosure about Market Risk	22
Item 8.	Financial Statements	22
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosure	22
Item 9A.	Controls and Procedures	22
Item 9B.	Other Information	22
PART III		
Item 10.	Directors, Executive Officers, Promoters and Control Persons and Corporate Governance; Compliance with Section 16 (a) of the Exchange Act	23
Item 11.	Executive Compensation	25
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	28
Item 13.	Certain Relationships and Related Transactions, and Director Independence	29
Item 14.	Principal Accounting Fees and Services	30
PART IV		
Item 15.	Exhibits and Financial Statement Schedules	31

SIGNATURES 34

EXHIBITS

FORWARD-LOOKING STATEMENTS

Certain statements made in this Annual Report on Form 10-K are “forward-looking statements” (within the meaning of the Private Securities Litigation Reform Act of 1995) regarding the plans and objectives of management for future operations. Such statements involve known and unknown risks, uncertainties and other factors that may cause actual results, performance or achievements of Milestone to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Milestone’s plans and objectives are based, in part, on assumptions involving the continued expansion of business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond the control of Milestone. Although Milestone believes that its assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, particularly in view of Milestone’s early stage

operations, the inclusion of such information should not be regarded as a representation by Milestone or any other person that the objectives and plans of Milestone will be achieved. Milestone undertakes no obligation to revise or update publicly any forward-looking statements for any reason.

PART I

Item 1. Description of Business

All references in this report to "Milestone," "us," or "Milestone Scientific" refer to Milestone Scientific Inc. unless the context otherwise indicates. Milestone has rights to the following trademarks: CompuDent®, CompuMed®, CompuFlo®, The Wand®, The Wand Plus®, The SafetyWand®, Cool Blue Wand®, Cool Blue Tooth Whitening Instrument™, Dynamic Pressure Sensing Technology®, STA Single Tooth Anesthesia™, (STA Instrument, instruments and handpieces), Ionic White® (light emitting diode), and Ionic White™ (whitening toothpaste). Milestone was incorporated in the State of Delaware in 1989.

BUSINESS

Background

Milestone since its inception has engaged in pioneering proprietary, innovative, computer-controlled injection technologies and solutions for the medical and dental markets. Milestone has focused its energy and resources on redefining the worldwide standard of care for injection techniques by making the experience more comfortable for the patient and by reducing the anxiety and stress of administering injections for the healthcare provider.

Milestone and its technology are widely recognized by key opinion leaders, industry experts and medical and dental practitioners as the noted leader in the emerging, high growth, computer-controlled injection industry; and remains intent on expanding the use and application of its proprietary, patented technologies to achieve greater operational efficiencies, enhanced patient safety and therapeutic adherence, and improved quality of care within a broad range of medical disciplines.

In 1997, Milestone first introduced The Wand® (CompuDent® instrument) and the disposable Wand handpiece. CompuDent provides painless injections for all routine dental treatments, including root canals, crowns, fillings and cleanings. Milestone's Computer-Controlled Local Anesthetic Delivery (C-CLAD) instrument handpiece does not look or feel like a syringe. And, what's more, it works better than a syringe, resulting in a more pleasant experience for the patient and practitioner.

Milestone subsequently expanded its product offerings with the introduction of the CompuMed® advanced injection instrument, designed for use in a wide range of applications within the medical industry, including cosmetic surgery, hair restoration surgery, podiatry, colorectal surgery, nasal and sinus surgery, dermatology and orthopedics, among others.

Central to Milestone's intellectual property platform and current product development strategy is its patented CompuFlo® technology for the precise delivery of medicaments. The CompuFlo pressure/force Computer-Controlled Local Anesthetic Delivery (C-CLAD) technology is an advanced, patented and FDA-approved medical technology for the painless and accurate delivery of drugs, anesthetics and other medicaments into all tissue types, as well as for the aspiration of bodily fluids or previously injected substances. Its regulation and control of flow rate continues to provide the CompuDent and CompuMed benefits of painless injections, while its Dynamic Pressure Sensing® capability provides visual and audible in-tissue pressure feedback, identifying tissue types to the healthcare provider. This pressure feedback extends the benefit of painlessness from anesthetics with known viscosities to a wide range of liquid drugs and other medicaments with varying viscosities and flow rates. Dynamic Pressure Sensing also allows the healthcare provider to know when certain types of tissues have been penetrated and permits the healthcare provider to inject medicaments precisely at the desired location. Thus, pressure feedback can prevent the suffusion of tissue outside the intended target area, a vitally important characteristic in the injection of chemotherapeutics and other toxic

substances.

The CompuFlo technology consists of two critical elements. One element is the ability to determine exit pressure In Situ (in the injection site tissue) at the tip of the needle in real time. This minimizes tissue damage (and eliminates the pain of the injection) because the flow rate and pressure of the injection are controlled. The other critical element of the technology is an integrated injection database of algorithms that have been defined which allow for the measurement of the exit pressure. This database of algorithms contains the critical components of specific drugs, parameters of needles, tubing and syringes and all other pertinent components for the safe and efficacious delivery of medications for all procedures.

The CompuFlo technology also consists of a disposable injection handpiece that provides for precise tactile control during the injection, an electromechanical (computer-controlled) fluid delivery instrument and the ability to record data from the injection event. As confirmed by numerous noted medical and dental experts within academia and the clinical practice arenas, CompuFlo has the potential to greatly increase the safety and efficacy of many drug delivery procedures that currently rely upon the over 150-year-old hypodermic syringe technology and the tactile senses and delivery expertise of the administrator.

On September 14, 2004, Milestone Scientific was issued United States Patent No. 6,786,885 for the CompuFlo technology, entitled "Pressure/Force Computer Controlled Drug Delivery Instrument with Exit Pressure." Proprietary software, working with an innovative technology, allows the instrument to continuously monitor and control the exit pressure of fluid and/or medication during an injection. This same technology also enables doctors to accurately identify different tissue types based on exit pressure during an injection. The technology has numerous applications in both medicine and dentistry, including epidural and intra-articular injections.

In December 2004, the United States Patent Office issued a "Notice of Allowance" for patent protection on two additional critical elements of the CompuFlo automated drug delivery technology: "Drug Delivery Instrument with Profiles" and "Pressure/Force Computer Controlled Drug Delivery with Automated Charging".

In December 2005, Milestone submitted a pre-market notification to the U.S. Food and Drug Administration (FDA) on its CompuFlo technology, which was subsequently cleared by the FDA in July of 2006. This initial submission was critical for Milestone's continuing efforts to develop and commercialize this important technology. Milestone has identified a number of potential applications for CompuFlo, including single-tooth dental injections, self-administered drug delivery, osteoarthritis joint pain management and epidurals.

Given Milestone's experience and established brand awareness within the dental industry, it elected to focus its initial product development efforts on the integration of CompuFlo into its legacy computer-controlled dental injection instrument. As a result, Milestone developed the industry's first solution for painlessly administering a single-tooth injection as the only injection necessary for achieving anesthesia, foregoing the need to administer a traditional nerve branch block. This new instrument, which also provides for use of a disposable handpiece, was trademarked the "STA Single Tooth Anesthesia Instrument™," now more commonly known as the STA Instrument.

After receiving FDA 510(k) Pre-market Notification acceptance for the marketing and sale of the STA Instrument, Milestone introduced the instrument to market in February 2007 at the Chicago Dental Society's 143rd Midwinter Meeting. The patented STA Instrument incorporates the "pressure feedback" elements of Milestone's patented CompuFlo technology, thereby allowing dentists to administer injections accurately and painlessly into the periodontal ligament space, effectively anesthetizing a single tooth. This injection is of significant value in that it allows the dentist to profoundly anesthetize the tooth within one or two minutes, versus up to 15-18 minutes for a block injection to take effect. Utilizing the STA Instrument single tooth injection, the patient will suffer neither pain nor collateral anesthesia in the cheek, lips or tongue at any time. The STA Instrument is capable of performing all of the injections that can be done with a conventional dental syringe, including the palatal-anterior superior alveolar, anterior middle superior alveolar and inferior alveolar nerve block. The STA Instrument achieves these injections predictably and reliably.

Initial market response to the STA Instrument following its commercial debut in February 2007 proved to be less than robust. Moreover, at that time, Milestone had granted exclusive U.S. and Canadian distribution and marketing rights for the STA Instrument to Henry Schein, Inc., the largest distributor of healthcare products and services to office-based practitioners in the combined North American and European markets. Following several months of lackluster sales and after making critical senior management changes, Milestone initiated an in-depth market study to reassess its positioning and marketing strategies for the STA Instrument. The insight gained from this study led management to redefine and implement a new messaging platform, created to emphasize key benefits that Milestone discovered are of most value to dental professionals. This new product messaging was launched in January 2008 and has remained in constant review.

In the spring of 2009, Milestone signed an Exclusive Distribution and Marketing Agreement with China National Medicines Corporation, dba Sinopharm, which is China's largest domestic manufacturer, distributor and marketer of pharmaceuticals and importer of medical devices and the country's largest domestic distributor of dental anesthetic carpules to the Chinese dental industry. Prior to the end of 2009, China National Medicines issued Milestone a blanket purchase order for 12,000 STA instruments and related handpieces to be delivered over 36 months, thereby marking

Milestone's initial penetration into China's emerging dental market.

In early October 2012, the State Food and Drug Administration (SFDA) of the People's Republic of China approved Milestone's Single Tooth Anesthesia System® (STA System). Unfortunately, the SFDA bifurcated approval of the STA Systems from the Wand® handpieces. SFDA approval of the Wand® handpieces is expected. Therefore, shipment of STA handpieces continue to be suspended pending the approval to sell and distribute this products in China. It is expected that the approval by the appropriate Chinese regulatory body will be received.

According to a report published by the U.S. Department of Commerce, titled "China's Emerging Markets: Opportunities in the Dental and Dental Lab Industry," China's dental market lags behind other healthcare services and has largely been neglected in the past. In fact, CS Market Research reports that "of China's 1.3 billion plus population, 50% of the adults and 70% of the children are estimated to have decayed tooth problems, and over 90% have periodontal disease." However, with increasing affluence of the Chinese population, as well as increasing attention towards personal care, demand for dental services has been growing. Market research firm Freedonia agrees, noting that demand for dental products in China is expected to climb to 21.5 billion RMB (U.S. $3.15 billion) by 2012, due primarily to escalating personal income levels and government programs promoting awareness of the benefits of good oral care.

Shortly before the end of the second quarter of 2009, Milestone elected to refine its international marketing strategy to gain greater access to and penetration of the international dental markets. The new sales strategy provides for increasing hands-on oversight and support of its existing international distribution network, while also attracting new distributors throughout Europe, Asia and South America.

Beginning in the second and third quarter 2010, Milestone expanded its international and domestic sales force by hiring a Director of International Sales and Director of Domestic Sales. These additions have proven to be a valuable addition to our dental market business, as we expand our distribution in both markets.

In November 2012, Milestone signed an exclusive distributor and marketing agreement with a well known US domestic distributor, for the sale and distribution of the STA Instrument and handpieces in the United States and Canada. The marketing initiative will include participation in U.S. and Canadian dental shows, as well as pediatric dental shows; an active advertising initiative targeting major dental publications; and direct mailing campaigns to over 150,000 dentists across the U.S. and Canada.

In August 2013, Milestone appointed Henry Schein as is exclusive distributor in the USA and Canada for the CompuDent handpieces.

CompuFlo® Advanced Injection Technology – Core Technology

The CompuFlo technology is patented and embedded in the STA Instrument that is being sold worldwide in the dental market. CompuFlo technology has been tried and proven in human and animal studies, as well as by dentists in most parts of the world who are using the STA Instrument in their practices.

CompuFlo is a revolutionary new technology for injections. CompuFlo enables health care practitioners to monitor and precisely control "pressure," "rate" and "volume" during all injections and can be used to inject all liquid medicaments as well as anesthetics. CompuFlo can also be used to aspirate body fluids.

Negative side effects from the use of traditional hypodermic drug delivery injection instruments are well documented in dental and medical literature and include risk of death, transient or permanent paralysis, pain, tissue damage and post-operative complications. The pain and tissue damage are a direct result of uncontrolled flow rates and pressures that are created during the administration of drug solutions into human tissue. While several technologies have been capable of controlling flow rate, the ability to accurately and precisely control pressure has been unobtainable until the development of CompuFlo.

Precisely controlling in-tissue pressure increases patient safety by reducing the risk of tissue damage and post-treatment pain related to excessive pressure that may occur during certain injections. Identification of the tissue, in which the needle tip is imbedded, is believed to be highly important in epidural injections, intra-articular injections and numerous organ, subcutaneous and intramuscular injections.

CompuFlo's pressure sensing technology provides an objective tool that consistently and accurately identifies the epidural space by detecting the difference in pressure between the ligamentum flavum and the extraligamentary tissue.

In studies utilizing the CompuFlo technology the epidural space has been correctly identified 100 % of the time. Knowing the precise location of a needle during an epidural injection procedure provides a measure of safety not presently available to doctors using conventional syringes, who identify the epidural space by relying on the subjective perception of loss of resistance to saline.

In the absence of curative procedures, arthritis patients are obliged to endure multiple painful injections for a lifetime. Often these injections are not efficacious, because the doctor using a syringe failed to locate the intra-articular space or did not inject the appropriate volume of hyaluronic acid or other medicament into that space. The CompuFlo technology has been successful in administering viscous hyaluronic acid and other medicaments into the intra-articular space in both small and large joints using its computer-controlled pressure sensing capabilities in an independent animal study.

There are a number of injectable drugs routinely self-administered in a home or office setting using spring loaded automatic injection devices by people who suffer from long term chronic conditions such as Multiple Sclerosis and Rheumatoid Arthritis. The CompuFlo technology, using pressure sensing capabilities, can serve as a painless subcutaneous injection method for these self-administered drugs. A significant reduction in pain during delivery will have a positive impact on compliance, which is a major consideration when physicians are determining which drugs to prescribe.

In July 2011, Milestone entered into a definitive joint venture agreement with Beijing 3H (Heart-Help-Health) Scientific Technology Co., Ltd. (Beijing 3H) for the development, commercialization, manufacture and marketing of epidural and intra-articular injection instruments. Milestone held a 50% interest in the joint venture and Beijing 3H, whose shareholders are a number of individuals, including a large shareholder in Milestone who is also the principal of a supplier to Milestone, Bejing 3H also held a 50% interest in joint venture.

The joint venture provided for Milestone's contribution of an exclusive worldwide royalty-free license to use its patents. Beijing 3H has contributed $1.5 million to the joint venture to design and develop two commercial instruments using Milestone's CompuFlo® technology and disposables. Milestone will have distribution responsibility in the U.S., Canada and the rest of the world, while Beijing 3H will distribute products exclusively in the People's Republic of China, Macao, Hong Kong and other regions of Asia.

In the fourth quarter of 2013, the joint venture medical company, Milestone Medical Inc. sold 2 million shares of its common stock for $1.50 per share (total of $3.0 million) in a private placement transaction in Poland. As a result of the sale, the initial joint venture partners reduced their ownership percentages in Milestone Medical Inc. to 45.5% respectively.

Product Platform

Milestone has developed and brought to market a highly differentiated portfolio of industry innovations. Thus far, Milestone's proprietary solutions have succeeded in elevating the standard of care in the professional dental arena. The product portfolio includes:

STA Single Tooth Anesthesia Instrument™ (STA Instrument)

The STA Single Tooth Anesthesia Instrument™ (STA Instrument) is a patented, computer-controlled local anesthesia delivery instrument that incorporates the "pressure feedback" elements of Milestone's patented CompuFlo technology, thereby allowing dentists to administer injections accurately into the periodontal ligament space, effectively anesthetizing a single tooth. While the periodontal ligament injection has been available for some time, there has been no effective technology that allows dentists to easily perform the procedure painlessly, safely and predictably until now. With this unique procedure dentists can easily and predictably anesthetize a single tooth root in one minute and a multiple root tooth in two minutes, as compared to a general blocking injection and waiting up to 18 minutes (or longer if the blocking injection needs to be re-administered) before proceeding to perform a procedure on the target tooth. A device which allows dentists to effectively anesthetize a single tooth will greatly enhance the productivity of dental practices and, when combined with the painless injection capabilities already present in the CompuDent instrument, such a device provides a compelling value in the marketplace. The STA Instrument will generate recurring revenues from per-patient disposable handpieces.

Since its market introduction in the spring of 2007, the STA Instrument has received rave reviews and awards from the dental industry. In July 2007, noted industry publication Dentistry Today featured the STA Instrument as one of the "Top 100 Products in 2007," helping to promote much broader recognition of the instrument and validating STA's value proposition for dentists and patients, alike. In early 2008, Medical Device & Diagnostic Industry magazine distinguished the STA Instrument as a 2008 Medical Design Excellence Award winner in the "Dental Instruments, Equipment and Supplies" product category. Of the 33 products to receive this coveted award, the STA was one of only

two winning products that serve dental practitioners. In December 2008, Milestone continued to win broad acclaim for the STA Instrument by winning a "Townie Choice Award". The "Townie Choice" awards were originally started by Dr. Howard Darran and Farran Media, publisher of Dentaltown Magazine, to assist dentists in making product purchasing decisions, and are considered the "people's choice" of the products and services available to the dental industry today. That same month, the STA Instrument was also named as a Dental Products Report "Top 100 2008 Product of Distinction." Additionally, the STA Instrument was named one of Dentistry Today's "Top 100 Products" for the third consecutive year in 2010.

CompuDent®

CompuDent (also known as the Wand Plus® internationally) is Milestone's proprietary, patented Computer-Controlled Local Anesthetic Delivery (C-CLAD) instrument and predecessor of the STA Instrument. CompuDent delivers anesthesia at a precise and consistent rate below a patient's pain threshold. Over the years, CompuDent has been widely heralded as a revolutionary device, considered one of the major advances in dentistry in the 20th Century. The instrument has been favorably evaluated in more than 50

peer reviewed or independent clinical research reports. CompuDent, including its ergonomically designed single-use handpieces (The Wand®), provides numerous, well documented benefits:

- CompuDent minimizes the pain associated with palatal, mandibular block and all other injections, resulting in a more comfortable injection experience for the patient;
- the pencil grip used with The Wand handpieces allows unprecedented tactile sense and accurate control;
- new injections made possible with the CompuDent technology eliminate collateral numbness of the tongue, lips and facial muscles;
- bi-directional rotation of The Wand handpieces eliminates needle deflection resulting in greater success and more rapid onset of anesthesia in mandibular block injections;
- the use of a single patient use, disposable handpieces minimizes the risk of cross contamination; and
- the ergonomic design of The Wand handpieces makes an injection easier and less stressful to administer, lowering the risk of carpal tunnel syndrome.

Despite CompuDent's many benefits, including the administration of less painful and more comfortable injections, dentists in the United States have been slow to give up the use of traditional syringes. Dentists have all been trained to use syringes in dental school and often have become accustomed to and are comfortable with their use during many years of clinical practice, in spite of the obvious reluctance and/or fear of the patient in relation to injections administered by hypodermic syringe. There are approximately 40 million dental phobics, those people afraid to visit a dentist, in the United States. Therefore, Milestone believes there is a disconnect in the way dentists perceive their patients' attitudes toward injection by hypodermic syringe. The CompuDent is used today by thousands of dentists around the world, many of whom have long since abandoned the over 150-year old syringe.

CompuMed®

CompuMed is a patented computer-controlled injection instrument geared to the needs of the medical market and providing benefits similar to CompuDent. CompuMed allows many medical procedures, now requiring intravenous sedation, to be performed with only local anesthesia due to dramatic pain reduction. Also, dosages of local anesthetic can often be significantly reduced, thus reducing side effects, accelerating recovery times, lowering costs and eliminating potential complications. CompuMed has accumulated clinical evidence demonstrating benefits from use in colorectal surgery; podiatry; dermatology, including surgery for the removal of basal cell carcinomas and other oncological dermatologic procedures; nasal and sinus surgery, including rhinoplasty; hair transplantation and cosmetic surgery, among others.

The Wand®

The Wand handpiece is used in conjunction with the STA, CompuDent and CompuMed instruments. It is an ergonomically designed and patented handpieces that enables all traditional and newer injections, such as AMSA, P-ASA and Modified-PDL, to be more comfortable and easier to deliver. Moreover, the pen-like grasp of The Wand allows bi-directional rotation during injection, which prevents needle deflection that occurs with a traditional syringe. A straighter path results in a more accurate injection, meaning fewer missed mandibular blocks, and more rapid onset of anesthesia. Missed blocks are reported in the literature to occur 30% of the time. This raises both patient anxiety and difficulties for the dentists in managing their business. While awaiting profound anesthesia, the dentist is losing time and money.

Medical Instrument for Joint Venture

In July 2011, we entered into a definitive joint venture agreement with Beijing 3H (Heart-Help-Health) Scientific Technology Co., Ltd. (Beijing 3H) for the development, commercialization, manufacture and marketing of epidural and intra-articular injection instruments. Milestone Scientific held a 50% interest in the joint venture and Beijing 3H together with a number of individuals, including a large shareholder in Milestone who is also the principal of a supplier to Milestone, Bejing 3H also held a 50% interest in the joint venture.

In the fourth quarter or 2013, the joint venture medical company, Milestone Medical Inc issued 2 million shares of its common stock for $1.50 per share (total of $3.0 million) in a private placement transaction in Poland. As a result of the transaction, the initial joint venture partners reduced their ownership percentages in Milestone Medical Inc to 45.5 percent respectively. Milestone recorded a $1,363,650 Gain on the Dilutive Effect of these additional shares issued by Milestone Medical Inc.

Competition

Milestone's proprietary, patented Computer-Controlled Local Anesthesia Delivery (C-CLAD) instruments compete with disposable and reusable syringes that generally sell at lower prices and that use established and well-understood methodologies in both the dental and medical marketplaces.

Milestone's instruments compete on the basis of their performance characteristics and the benefits provided to both the practitioner and the patient. Clinical studies have shown that the instruments reduce fear, pain and anxiety for many patients, and Milestone believes that they can reduce practitioner stress levels, as well. Milestone's newest product introduction, the STA Instrument, can be used for all dental injections that can be performed with a traditional dental syringe. Moreover, the STA Instrument can also be used for new and modified dental injection techniques that cannot be performed with traditional syringes. These new techniques allow for faster procedures shortening chair-time, minimizing the numbing of the lips and facial muscles, enhancing practice productivity, reducing stress and virtually eliminating pain and anxiety for both the patient and the dentist.

Milestone faces intense competition from many companies in the medical and dental device industry, possessing substantially greater financial, marketing, personnel, and other resources. Most competitors have established reputations, stemming from their success in the development, sale, and service of competing dental products. Further, rapid technological change and research may affect the products. Current or new competitors could, at any time, introduce new or enhanced products with features that render the products less marketable or even obsolete. Therefore, Milestone must devote substantial efforts and financial resources to improve existing products, bring products to market quickly, and develop new products for related markets. In addition, the ability to compete successfully requires that Milestone establish an effective distribution network and with a strong marketing plan. Historically, Milestone has been unsuccessful in executing the marketing plans for the products, primarily due to resource constraints. New products must be approved by regulatory authorities before they may be marketed. Milestone cannot assure you that it can compete successfully; that competitors will not develop technologies or products that render the products less marketable or obsolete; or, that Milestone will succeed in improving the existing products, effectively develop new products, or obtain required regulatory approval for those products.

Patents and Intellectual Property

Milestone holds the following U.S. utility and design patents:

	U.S. PATENT NUMBER	DATE OF ISSUE
Computer Controlled Drug Delivery Systems		
Dental Anesthetic and Delivery Injection Unit	6,022,337	2/8/2000
Design for a Dental Anesthetic Delivery System Holder	D422,361	4/4/2000
Design for a Dental Anesthetic Delivery System Housing	D423,665	4/25/2000
Design for a Dental Anesthetic Delivery System Handle	D427,314	6/27/2000
Cartridge Holder for Injection Device	6,132,414	10/17/2000
Dental Anesthetic Delivery Injection Unit	6,152,734	11/28/2000
Microprocessor-controlled Fluid Dispensing Apparatus	6,159,161	12/12/2000
Pressure/Force Computer Controlled Drug Delivery System	6,200,289	3/13/2001
Dental Anesthetic and Delivery Injection Unit with Automated Rate Control	6,652,482	11/25/2003
Pressure/Force Computer Controlled Drug Delivery System with Exit Pressure	6,786,885	9/14/2004
Pressure/Force Computer Controlled Drug Delivery System with Automated Charging	6,887,216	5/3/2005
Drug Delivery System with Profiles	6,945,954	9/20/2005
Cartridge Holder for Anesthetic and Delivery Injection Device	D558,340	12/25/2007
Design for Drive Unit for Anesthetic	D566,265	4/8/2008
Design for Drive Unit for Anesthetic	D579,540	10/28/2008
Drug Infusion Device with Tissue Identification Using Pressure Sensing	7,449,008	11/11/2008
Computer Controlled Drug Delivery Systems with Pressure Sensing	7,618,409	11/17/2009
Hand Piece for Fluid Administration	7,625,354	12/1/2009
Self-Administration Injection System	7,740,612	6/22/2010
Computer controlled drug delivery system with dynamic pressure sensing	7,896,833	3/1/2011
Engineered Sharps Injury Protection Devices		
Handpiece for Injection Device with a Retractable and Rotating Needle	6,428,517	8/6/2002
Safety IV Catheter Device	6,726,658	4/27/2004
Safety IV Catheter Infusion Device	6,905,482	6/14/2005
Handpiece for Injection Device with a Retractable and Rotating Needle	6,966,899	11/22/2005

During the 2013 and 2012 fiscal years, Milestone expensed $191,345 and $181,979, respectively, on research and development activities. The higher costs incurred in 2013 were primarily associated with the continued development of the Single Tooth Anesthetic (STA) delivery instrument and continuing efforts on developing medical products utilizing the CompuFlo technology.

Milestone relies on a combination of patent, copyright, trade secret, and trademark laws and employee and third party nondisclosure agreements to protect intellectual property rights. Despite the precautions taken by Milestone to protect the products, unauthorized parties may attempt to reverse engineer, copy, or obtain and use products and information that Milestone regarded as proprietary, or may design products serving similar purposes that do not infringe on Milestone's patents. Milestone's failure to protect its proprietary information and the expenses of doing so could have a material adverse effect on the operating results and financial condition.

In the event that the products infringe upon patent or proprietary rights of others, Milestone may be required to modify processes or to obtain a license. There can be no assurance that Milestone would be able to do so in a timely manner,

upon acceptable terms and conditions, or at all. The failure to do so would have a material adverse effect on

389,783Average Pay Rate 4.45% 4.45% Average Receive Rate variable(2) variable(2) **Borrowings** Warehouse line of credit variable rate 53,475,879 53,475,879 53,475,879Average Interest Rate variable(1)

(1) Interest rates are based on the 30 day commercial paper rate plus 200 basis points.

(2) Interest rates received by us are reset to estimated market rate every three months (1.12% at December 31, 2003).

We determined the fair values included in the tables above based upon the best evidence available for each type of financial instrument, as discussed above in " Critical Accounting Policies and Management Estimates Derivative Instruments and Hedging Activities". For example, for interest rate swap contracts, the fair values are based on securities dealers' estimated prices. For securities purchased under resale agreements, the fair values are based on market prices or securities dealers' estimated prices. For securities sold, but not yet purchased, the fair values are based on the quoted market prices of the underlying securities.

37

FALCON FINANCIAL INVESTMENT TRUST AND PREDECESSOR

December 31, 2003

Item 8. Consolidated Financial Statements and Supplementary Data

Index to Consolidated Financial Statements

Independent Auditors' Report
Consolidated Statements of Financial Position
Consolidated Statements of Operations
Consolidated Statements of Changes in Stockholders'/Members' Equity (Deficit) and Comprehensive Income (Loss)
Consolidated Statements of Cash Flows
Notes to Consolidated Statements of Financial Statements

38

Independent Auditors' Report

The Board of Trustees
Falcon Financial Investment Trust:

We have audited the accompanying consolidated statements of financial position of Falcon Financial Investment Trust (the "Successor") as of December 31, 2003, and of Falcon Financial, LLC (the "Predecessor") as of September 30, 2003 and 2002, and the related consolidated statements of operations, changes in stockholders'/members' equity (deficit) and comprehensive income (loss) and cash flows for the periods from December 22, 2003 to December 31, 2003 (the "Successor Period"), and from October 1, 2003 to December 21, 2003, and for each of the years in the three-year period ended September 30, 2003 (the "Predecessor Periods"). These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement

presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the aforementioned Successor consolidated financial statements present fairly, in all material respects, the financial position of Falcon Financial Investment Trust and subsidiaries as of December 31, 2003, and the results of their operations and their cash flows for the Successor Period, in conformity with accounting principles generally accepted in the United States of America. Further, in our opinion, the aforementioned Predecessor consolidated financial statements present fairly, in all material respects, the financial position of Falcon Financial, LLC and subsidiaries as of September 30, 2003 and 2002, and the results of their operations and their cash flows for the Predecessor Periods, in conformity with accounting principles generally accepted in the United States of America.

As further discussed in Note (1), the Successor commenced operations on December 22, 2003 when it completed its initial public offering and concurrently consummated a merger with the Predecessor. The Successor has established the Predecessor's historical basis in the assets and liabilities subsequent to the merger.

/s/ KPMG LLP

New York, New York
March 26, 2004

FALCON FINANCIAL INVESTMENT TRUST AND PREDECESSOR

Consolidated Statements of Financial Position

	Company	Predecessor		
	December 31, 2003	**December 31, 2002**	**September 30, 2003**	**September 30, 2002**
		(unaudited)		
ASSETS				
ASSETS:				
Cash and cash equivalents	$ 25,645,578	$ 610,430	$ 492,198	$ 246,932
Loans, net (allowance for possible loan losses of $1,086,692)	126,076,622			
Loans held for sale		143,923,078	105,319,616	104,754,699
Securities purchased under resale agreements related party		32,047,500		11,262,500
Retained interests in loan securitization	7,239,136	5,481,626	7,347,881	7,508,193
Due from broker related party		6,440,000	80,842	5,630,000
Interest rate swap contracts related party	389,783			
Accrued interest receivable	994,821	1,188,023	624,199	992,029
Restricted cash	2,657,660	1,974,462	2,864,540	1,984,774
Property and equipment, net	335,860	429,091	352,083	461,278
Prepaid expenses and other assets	1,497,245	81,784	790,639	195,841
Total assets	$ 164,836,705	$ 192,175,994	$ 117,871,998	$ 133,036,246
LIABILITIES AND STOCKHOLDERS'/MEMBERS' EQUITY (DEFICIT)				
LIABILITIES:				
Borrowings	$ 53,475,879	$ 133,566,739	$ 97,317,254	$ 97,342,078
Borrowings related party		20,355,977	10,267,940	18,413,703
Securities sold, but not yet purchased related party		31,908,989		11,160,729
Accrued interest payable	255,707	174,556	82,307	139,091
Accrued interest payable related party		1,855,829	289,414	1,185,483
Due to broker related party		1,699,778		663,273

		Predecessor		
Customer deposits	140,276	542,665	389,439	643,458
Hold back of loan proceeds	2,657,660	1,974,462	2,864,540	1,984,774
Interest rate swap contracts related party		5,900,800	433,170	5,719,800
Accounts payable and accrued liabilities	2,405,496	512,426	1,651,301	375,814
Total liabilities	58,935,018	198,492,221	113,295,365	137,628,203
COMMITMENTS AND CONTINGENCIES				
STOCKHOLDERS'/MEMBERS' EQUITY (DEFICIT):				
Preferred shares, $0.01 par value, 50,000,000 authorized, none issued and outstanding				
Common shares, $0.01 par value, 100,000,000 authorized, 14,105,800 issued and outstanding	141,058			
Additional paid in capital	108,020,597			
Unearned compensation	(2,840,827)			
Members' capital		900,000	900,000	900,000
Retained earnings (accumulated deficit)	(1,090,858)	(8,528,914)	2,271,027	(7,353,358)
Accumulated other comprehensive income	1,671,717	1,312,687	1,405,606	1,861,401
Total stockholders'/members' equity (deficit)	105,901,687	(6,316,227)	4,576,633	(4,591,957)
Total liabilities and stockholders'/members' equity (deficit)	$ 164,836,705	$ 192,175,994	$ 117,871,998	$ 133,036,246

See accompanying notes to consolidated financial statements.

FALCON FINANCIAL INVESTMENT TRUST AND PREDECESSOR

Consolidated Statements of Operations

		Predecessor				
	Company Period From December 22, 2003 to December 31, 2003	**Period From October 1, 2003 to December 21, 2003**	**Three Months Ended December 31, 2002**	**Fiscal Year Ended September 30, 2003**	**Fiscal Year Ended September 30, 2002**	**Fiscal Year Ended September 30, 2001**
			(unaudited)			
REVENUES:						
Interest income on loans	$ 298,446	$ 2,477,173	$ 2,905,978	$ 8,073,880	$ 8,512,415	$ 6,709,110
Interest income on securities purchased under resale agreements related party			46,136	182,892	122,346	759,587
Interest income from retained interests	38,736	336,781	237,338	1,377,052	1,475,891	1,183,889
Gain on sale of loans				10,682,773	5,010,258	
Gain on sale of retained interests			597,609	850,874	155,707	582,578
Loss on sale of retained interests related party					(19,238)	

		Predecessor				
Change in value of interest rate swap contracts		283,170	(775,441)	(529,094)	(4,963,311)	(6,826,068)
(Loss) gain on securities sold, but not yet purchased related party			(1,033,025)	1,079,799	(857,174)	(1,403,183)
Income from loan servicing	11,022	101,763	79,919	395,541	294,899	196,965
Other income	7,612	70,902	277,905	579,673	428,598	510,293
Total revenues	355,816	3,269,789	2,336,419	22,693,390	10,160,391	1,713,171
EXPENSES:						
Interest expense on borrowings	76,712	262,708	460,620	1,102,690	1,589,815	2,878,959
Interest expense on borrowings related party		964,602	1,368,058	3,666,609	3,815,752	2,309,567
Interest expense on securities sold, but not yet repurchased related party			181,671	1,252,746	503,624	1,161,018
Provision for possible loan losses	1,086,692					
Facility fee expense related party	75,000	456,250	93,750	375,000	385,000	375,000
Other than temporary decline in value of retained interests				422,477	178,251	
Salaries and benefits	108,159	863,452	807,212	3,822,509	2,906,479	2,602,352
Professional fees	65,818	532,676	161,186	600,562	350,360	245,830
General and administrative	19,435	177,460	144,903	663,029	584,854	647,700
Advertising and promotion	11,988	192,985	194,552	768,494	827,499	894,935
Travel and entertainment		87,547	64,434	259,709	221,207	251,378
Depreciation and amortization	2,870	26,252	35,589	135,180	100,360	90,177
Total expenses	1,446,674	3,563,932	3,511,975	13,069,005	11,463,201	11,456,916
Net (loss) income	$ (1,090,858)	$ (294,143)	$ (1,175,556)	$ 9,624,385	$ (1,302,810)	$ (9,743,745)
Net loss per share basic and diluted	$ (0.08)					
Weighted Average shares outstanding:						
Basic	13,787,500					
Diluted	14,100,582					

See accompanying notes to consolidated financial statements.

FALCON FINANCIAL INVESTMENT TRUST AND PREDECESSOR

Consolidated Statements of Changes in Shareholders'/Members' Equity (Deficit) and

Comprehensive Income (Loss)

	Common Stock								
	Number of Shares	**Par Value ($0.01 per share)**	**Additional Paid-In Capital**	**Unearned Compensation**	**Members' Capital**	**Retained Earnings (Accumulated Deficit)**	**Accumulated Other Comprehensive Income**	**Total Shareholders'/ Members' Equity (Deficit)**	**Comprehensive Income (Loss)**
BALANCE, September 30, 2000		$	$	$	$ 900,000	$ 3,693,197	$ 489,922	$ 5,083,119	
Net loss						(9,743,745)		(9,743,745)	$ (9,743,745)
Unrealized loss on retained interests in loan securitizations, adjusted for gains realized on sales							(72,115)	(72,115)	(72,115)
Comprehensive loss									$ (9,815,860)
BALANCE, September 30, 2001					900,000	(6,050,548)	417,807	(4,732,741)	
Net loss						(1,302,810)		(1,302,810)	$ (1,302,810)
Other than temporary decline in value of retained interest charged to expense							178,251	178,251	178,251
Unrealized gain on retained interests in loan securitizations, adjusted for gains realized on sales							1,265,343	1,265,343	1,265,343
Comprehensive income									$ 140,784
BALANCE, September 30, 2002					900,000	(7,353,358)	1,861,401	(4,591,957)	
Net Income						9,624,385		9,624,385	$ 9,624,385
Other than temporary decline in value of retained interest charged to expense							422,477	422,477	422,477
Unrealized loss on retained interests in loan securitizations, adjusted for gains realized on sales							(878,272)	(878,272)	(878,272)
Comprehensive income									$ 9,168,590
BALANCE, September 30, 2003					900,000	2,271,027	1,405,606	4,576,633	
Net Loss the Predecessor (October 1 December 21, 2003)						(294,143)		(294,143)	$ (294,143)
Formation Transaction on December 22, 2003:									
Issuance of shares in connection with merger of Predecessor into the Company	1,287,500	12,875	2,864,009		(900,000)	(1,976,884)			
Issuance of shares in connection with Initial	12,500,000	125,000	112,375,000					112,500,000	

	Common Stock								
Public Offering									
Underwriters' Fee and Offering Expenses			(10,079,929)					(10,079,929)	
Restricted stock awards	318,300	3,183	2,861,517	(2,864,700)					
Amortization of restricted stock awards				23,873				23,873	
Net loss the Company (December 22 December 31, 2003)						(1,090,858)		(1,090,858)	(1,090,858)
Unrealized gains on cash flow hedges							389,784	389,784	389,784
Unrealized loss on retained interests in securitizations							(123,673)	(123,673)	(123,673)
Comprehensive loss									$ (1,118,890)
BALANCE, December 31, 2003	14,105,800	$ 141,058	$ 108,020,597	$ (2,840,827)	$	$ (1,090,858)	$ 1,671,717	$ 105,901,687	

See accompanying notes to consolidated financial statements.

FALCON FINANCIAL INVESTMENT TRUST AND PREDECESSOR

Consolidated Statements of Cash Flows

		Predecessor				
	Company Period From December 22, 2003 to December 31, 2003	**Period From October 1, 2003 to December 21, 2003**	**Three months ended December 31, 2002**	**Fiscal year ended September 30, 2003**	**Fiscal year ended September 30, 2002**	**Fiscal year ended September 30, 2001**
			(unaudited)			
Cash flows from operating activities						
Net (loss) income	$ (1,090,858)	$ (294,143)	$ (1,175,556)	$ 9,624,385	$ (1,302,810)	$ (9,743,745)
Adjustments to reconcile net income (loss) to net cash used in operating activities:						
Gain on sale of loans				(10,682,773)	(5,010,258)	
Gain on sale of retained interests			(597,609)	(850,874)	(155,707)	(582,578)
Loss on sale of retained interests related party					19,238	
Other than temporary decline in value of retained interest				422,477	178,251	
Depreciation and amortization property and equipment	2,870	26,252	35,589	135,180	100,360	90,177
Depreciation and amortization deferred origination fees, net of expense	(3,366)	(27,908)	(24,728)	(55,047)	(60,840)	
(Gain) loss on disposition of property and equipment				170	28,502	
Provision for possible loan losses	1,086,692					

	Company Period From December 22, 2003 to December 31, 2003					
Accretion of discount on retained interests	2,067	30,775	117,683	102,416	7,452	207,386
Changes in operating assets and liabilities:						
Increase (Decrease) in securities sold, but not yet purchased related party			20,748,260	(11,160,729)	(13,518,704)	24,679,433
Increase (Decrease) in interest rate swap contracts related party		(433,170)	181,000	(5,286,630)	(569,300)	6,289,100
Increase (Decrease) in securities purchased under resale agreements related party			(20,785,000)	11,262,500	13,670,625	(24,933,125)
Increase (decrease) in due from broker related party		80,842	(810,000)	5,549,158	(1,230,000)	(3,966,983)
(Increase) decrease in accrued interest receivable	(298,446)	(72,176)	(195,994)	367,830	974,467	(1,966,496)
Decrease (increase) in prepaid expenses and other assets	359,088	(1,065,694)	114,057	(594,798)	442,828	(562,957)
(Decrease) increase in due to broker related party	(149,993)	149,993	1,036,505	(663,273)	26,333	636,940
Increase (decrease) in accrued interest payable	23,808	(26,755)	35,465	(56,784)	(223,876)	362,967
Increase (decrease) in accrued interest payable related party	11,791	(124,858)	670,346	(896,069)	(1,164,581)	2,350,064
(Decrease) increase in customer deposits	(1,950)	(247,213)	(100,793)	(254,019)	57,838	(92,557)
(Decrease) Increase in accounts payable and accrued liabilities	(227,605)	(28,843)	136,612	1,275,487	(203,347)	(261,172)
Net cash used in operating activities	(285,902)	(2,032,898)	(614,163)	(1,761,393)	(7,933,529)	(7,493,546)
Cash flows from investing activities:						
Disbursements for loan originations, net of fees received	12,344	(22,691,338)	(40,049,623)	(146,409,407)	(99,684,069)	(147,835,202)
Repayments of loans		842,674	848,349	6,149,256	2,571,689	1,469,653
Net proceeds from sale of retained interests			2,015,402	4,998,962	1,586,993	1,967,282
Net proceeds from sale of retained interests related party					2,321,929	
Net proceeds from sale of loans				145,464,590	138,565,191	
Net purchases of property and equipment		(12,899)	(3,402)	(26,155)	(461,544)	(74,297)
Net cash provided (used in) by investing activities	12,344	(21,861,563)	(37,189,274)	10,177,246	44,900,189	(144,472,564)
Cash flows from financing activities:						
Proceeds from initial public offering	112,500,000					
Payment of offering expenses	(9,069,287)					
Borrowings from warehouse line of credit		21,001,300	37,073,010	135,333,423	92,103,960	138,034,673
Repayments of warehouse line of credit	(64,000,000)	(842,674)	(848,349)	(135,358,247)	(131,326,902)	(1,469,653)
Borrowings from subordinated loans		3,376,200	8,498,025	22,529,926	21,666,944	18,997,515
Repayments of subordinated loans	(12,670,200)		(6,690,000)	(30,315,746)	(22,535,139)	(1,349,500)
Borrowings from interest capitalization notes		74,023	134,249	326,164	403,115	265,866
Repayments of interest capitalization notes	(1,047,963)			(686,107)		
Net cash provided by (used in) financing activities	25,712,550	23,608,849	38,166,935	(8,170,587)	(39,688,022)	154,478,901

	Company Period From December 22, 2003 to December 31, 2003					
Net increase (decrease) in cash and cash equivalents	25,438,992	(285,612)	363,498	245,266	(2,721,362)	2,512,791
Cash and cash equivalents, beginning of period	206,586	492,198	246,932	246,932	2,968,294	455,503
Cash and cash equivalents, end of period	$ 25,645,578	$ 206,586	$ 610,430	$ 492,198	$ 246,932	$ 2,968,294
Supplemental disclosure of cash flow information:						
Interest paid	274,926	1,782,743	2,222,731	$ 8,156,491	$ 10,515,322	$ 6,087,025
Offering expenses accrued at December 31, 2003	1,010,642					

See accompanying notes to consolidated financial statements.

FALCON FINANCIAL INVESTMENT TRUST AND PREDECESSOR

Notes to Consolidated Financial Statements

(1) Organization

Falcon Financial Investment Trust (the "Trust") is a fully integrated, self-advised finance company focused solely on the business of originating and servicing loans to automotive dealers in the United States. The Trust was formed as a Maryland Real Estate Investment Trust ("REIT") on August 27, 2003. The Trust was formed to address the specialized capital needs of the automotive retailing industry. The Trust commenced operations on December 22, 2003 when it completed its initial public offering ("IPO") and concurrently consummated certain other formation transactions, including a merger with Falcon Financial, LLC (the "Predecessor"). The Trust established the Predecessor's historical basis in the assets and liabilities subsequent to the merger. The Trust also formed a wholly-owned taxable REIT subsidiary, Falcon Financial II, LLC, which will engage in the principal activities of originating and servicing loans.

The IPO consisted of the sale of 12,500,000 common shares to the public at a price of $9 per share, generating gross proceeds of $112.5 million. The aggregate proceeds to the Trust, net of underwriters' discount and offering costs, was approximately $102.4 million. Concurrent with the IPO, the Trust issued 1,287,500 common shares to the owners' of its Predecessor as part of the formation transaction in acquiring the assets and assuming the liabilities of the Predecessor. Also concurrent with the IPO, the Trust issued 318,300 restricted shares as part of its Equity Incentive Plan to its independent trustees, trustee nominees, members of senior management and other employees. The total number of common shares outstanding immediately following the IPO was 14,105,800. On February 2, 2004 the Company issued an additional 1,875,000 common shares at a price of $9 per share, which generated additional proceeds (net of the underwriters' discount) of $15,693,750 as a result of the exercise of the underwriters' over-allotment option. The issuance of these additional shares brings the total number of common shares issued and outstanding to 15,985,800.

The Predecessor was owned by Falcon Auto Ventuire, LLC (40%), SunAmerica, Inc. (30%), and MLQ Investors, LP (an affiliate of Goldman, Sachs & Co.) (30%). Members of the senior mangement of the Company owned an 86% interest in Falcon Auto Venture, LLC. Subsequent to the IPO, owners of the Predecessor collectively own 10.3% of the Trust, with no individual owning greater than 5%.

Concurrent with the completion of the IPO, the Trust authorized 50 million preferred shares of beneficial interest. No preferred shares have been issued.

The Trust utilized its net proceeds of $102.4 million to repay $77.7 million in borrowings. After repayment of certain borrowings, the Trust had $24.7 million in available cash immediately following the IPO.

All amounts as of December 31, 2002 and for the three month period ended December 31, 2002 are unaudited.

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation

These consolidated financial statements presented herein include all of the accounts of the Trust and its wholly owned subsidiary Falcon Financial II, LLC (collectively, the "Company") beginning with the commencement of operations on December 22, 2003. Prior to that time, this report includes the consolidated financial statements of the Predecessor and its subsidiary. All intercompany transactions and account balances have been eliminated in consolidation.

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

(b) Cash Flows

For purposes of the statements of cash flows, the Company and its Predecessor consider all highly liquid investments with maturities of less than three months at the date of acquisition to be cash equivalents. These assets are carried at cost, which approximates fair value. Restricted cash is not considered cash or cash equivalents for the purpose of the statements of cash flows.

(c) Loans, net

The Company originates loans that are underwritten with the intention of securitizing the receivables in a financing transaction, which will be accounted for as secured borrowings under the provisions of SFAS Statement No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities", and carry the loans on the statement of financial position to maturity. The loans receivable are stated at their principal amount outstanding, less net deferred loan fees, unearned discounts and allowance for loan losses. Nonrefundable origination fees less certain related direct costs associated with the origination of the loans are deferred and amortized into interest income over the term of the loan using a method that approximates the interest method.

All loans originated by the Predecessor were underwritten with the intention of securitizing and were accounted for as loans held for sale on the statement of financial position. The amount (if any) by which the cost basis of the loans exceeds their estimated fair value is recorded through a valuation allowance. Changes in the valuation allowance are recorded in the statement of operations. As of September 30, 2003 and 2002 and December 31, 2002, no valuation allowance was deemed necessary.

(d) Allowance for Possible Loan Losses

The allowance for possible loan losses is based on a periodic analysis of the loan portfolio and in management's judgment, reflects an amount that is adequate to absorb losses inherent in the existing portfolio. In evaluating the portfolio, management considers a variety of factors such as the size of the portfolio, prior loss experience, current and potential risks of the loan portfolio, present financial condition of the borrower, current economic conditions and other portfolio risk characteristics. Provisions for possible loan losses are charged to operations. Loans, including impaired loans, are charged off against the allowance for possible loan losses when actual losses have been established.

A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. A loss from impairment represents the amount by which a creditor's recorded investment in a loan exceeds the present value of the expected future cash flows from the loan discounted at the loan's effective interest rate (including the fair value of the collateral that may be part of the loan). Losses for which such provisions for impairment are made, unless applied as a write-down of the recorded investment in the loan, represent a portion of the creditor's allowance for loan losses.

(e) Retained Interests in Loan Securitizations

The Predecessor accounted for its loan securitizations in accordance with Statement of Financial Accounting Standards (SFAS) No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement 125*. When the Company sells loans in a securitization, it may retain one or more subordinated certificates from the certificates issued. Securitizations may be structured in various ways but generally conform to a common model. Typically, an issuer sells a portfolio of loans to a special-purpose entity established for the sole purpose of purchasing and reselling the loans to a securitization trust. The securitization trust then may issue bonds or certificates collateralized by the loans transferred to the securitization trust. The proceeds received from these bonds or certificates are used to

purchase the loans from the issuing entity. The gain on the sale of loans is the difference between the proceeds from the sale of loans (net of related sale costs) and the allocated carrying amount of the receivables sold, including deferred origination fees and costs. The Company determines the carrying amount by allocating the total carrying amount of the loans sold between the portion sold and the interests retained based on each portion's relative fair values at the time of the securitization. Assumptions used in calculating the estimated fair value of such retained interests are subject to volatility that could materially affect operating results.

Retained interests in securitizations are accounted for as available for sale securities and are carried at estimated fair value, with unrealized gains or losses included in members' equity (accumulated other comprehensive income or loss). The Company is not aware of an active market for the purchase and sale of these retained interests at this time; accordingly, the Company estimates the fair value of the retained interest by calculating the present value of the estimated expected future cash flows received by the Company after being released by the securitization trust, using a discount rate commensurate with the risk involved taking into consideration the results of sales of certificates owned by the Company to third parties. The cash flows being discounted are adjusted for estimated net losses due to defaults or prepayments. The Company has experienced four defaults (of which one has been fully resolved resulting in a $2.8 million realized loss) and no prepayments in its retained interests in securitizations at December 31, 2003. All other loans are current.

Each loan securitization has a specific credit enhancement in the form of cash flow requirements that must be met before the Company receives any cash on its retained interest. The retained interests which the Company holds are subordinate in the right of payment to all other classes of certificates, which must receive their applicable distributions before any cash is available for distribution to the holders of the retained interests.

Changes in the fair value of the retained interests resulting from changes in the timing of cash flows to be received by the Company or changes in market interest rates are adjusted through other comprehensive income in stockholders'/ members' equity (deficit). Reductions in the estimated aggregate cash flows to be received by the Company, caused by defaults or prepayments that result in a reduction to the fair value below the historical cost basis of the retained interests, are considered an other than temporary impairment and are recognized through a charge to expense in that period.

(f) Restricted Cash and Holdback of Loan Proceeds.

The Company maintains various escrow accounts on behalf of its borrowers to fund work that needs to be performed on the borrower's property as a condition to the loan agreement. At December 31, 2003, 2002 and September 30 2003 and 2002, the Company held $2,657,660, $1,974,462

(unaudited), $2,864,540 and $1,984,774, respectively, of cash collateral for the completion of those projects.

(g) Interest and Fees on Loans

Interest is accrued monthly on outstanding principal balances unless management considers the collection of interest to be uncertain (generally, when loans are contractually past due three months or more).

Origination fees received and direct costs incurred related to the origination of the loans are deferred as an adjustment to the carrying value of the loans held for sale. Origination fees and direct costs incurred are amortized into income over the life of the related loan. At the time of sale of the related loans, any remaining deferred fees and costs are recognized as income and included with the gain or loss on the sale of such loans.

(h) Servicing Income

Under servicing agreements for all Company securitizations, servicing fees for loans in good standing are accrued monthly based upon the then outstanding principal balances on loans serviced. The Company acts as primary servicer and special servicer with respect to loans securitized. A subsidiary of the Bank of New York acts as Master Servicer. The Company earns a servicing fee of 0.085% per annum (0.095% on the Company's most recently completed securitization in 2003) of the outstanding loan balance with respect to each loan serviced in its capacity as primary servicer. As special servicer, the Company will earn a servicing fee of 0.25% per annum of the outstanding balance of each loan in default. Servicing fees on defaulted loans are earned and paid monthly once a loan enters default status. As of December 31, 2003, there is one loan in default. Fees received for loan servicing approximate the actual cost of servicing.

(i) Securities Sold, But Not Yet Purchased

The Predecessor entered into certain transactions (short sales and purchases, and securities resale and repurchase agreements) to mitigate the effects that changes in interest rates and credit spreads have on the fair value of its fixed rate loan portfolio held for sale. In connection with the Predecessor's short sales, its obligation to deliver the securities to Goldman, Sachs & Co. is recorded in the statement of financial position under the caption Securities sold, but not yet purchased. This liability is carried at market value with any unrealized gain or loss recorded in the statement of operations. The related interest expense is recorded in the income statement of operations over the period held.

(j) Securities Purchased Under Resale Agreements

Purchases of securities under agreements to resell and sales of securities under agreements to repurchase are accounted for as secured lending and financing transactions, respectively. In connection with the Predecessor's purchase contracts, its obligation to resell the securities to Goldman, Sachs & Co. is recorded in the Statement of Financial Position under the caption Securities purchased under resale agreements. These assets are carried at the amounts at which the identical securities will be subsequently resold as specified in the agreements, generally at market value. The related interest income is recorded in the statements of operations over the contract period.

(k) Interest Rate Swap Contracts

The Company enters into forward starting interest rate swap contracts as a means of mitigating the impact that changes in interest rates and credit spreads with respect to the forecasted issuance of long-term debt. The contracts are evaluated at inception and on an on-going basis in order to determine whether the contracts qualify for cash flow hedge accounting under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", as amended and interpreted. The hedge instrument must be highly effective in achieving offsetting changes in the hedged item attributable to the risk being hedged in order to qualify for hedge accounting treatment. Forward starting interest rate swaps accounted for cash flow hedges are carried on the statement of financial position at fair value with changes in their fair value recorded in accumulated other comprehensive income (loss). Any ineffectiveness which arises during the hedging relationship is recognized in interest expense during the period in which it arises.

The Predecessor entered into interest rate swap arrangements to mitigate the impact that changes in interest rates and credit spreads have on the value of its fixed rate loan portfolio held for sale. The term of the derivative contracts is determined by duration of the loans held for sale pool. Swap contracts are carried at market value with any unrealized gain or loss recorded in the statement of operations. The related interest income and interest expense is recorded in the statements of operations over the period held.

(l) Property and Equipment

Property and equipment are reported at cost less accumulated depreciation. Depreciation is recorded on a straight-line basis over five years for furniture and fixtures, and three years for computers and equipment. Leasehold improvements are amortized over the remaining term of the respective leases.

Depreciation expense for the period October 1, 2003 to December 21, 2003, the period December 22, 2003 to December 31, 2003 and the three months ended December 31, 2002, was $26,252, $2,870 and $35,589 (unaudited), respectively. Depreciation expense for the years ended September 30, 2003, 2002 and 2001 was $135,180, $100,360 and $90,177, respectively. Fixed assets as of December 31, 2003, and 2002 and September 30, 2003 and 2002 are summarized as follows:

	December 31, 2003	December 31, 2002	September 30, 2003	September 30, 2002
		(unaudited)		
Furniture and fixtures	$ 322,140	$ 320,545	$ 320,545	$ 319,220
Computers and equipment	396,412	362,525	385,108	360,448
Leasehold improvements	79,363	79,363	79,363	79,363
	797,915	762,433	785,016	759,031
Less: accumulated depreciation and amortization	(462,055)	(333,342)	(432,933)	(297,753)
	$ 335,860	$ 429,091	$ 352,083	$ 461,278

(m) Equity incentive and Option plan

Immediately prior to the IPO, the Company adopted an equity incentive plan and issued 318,300 restricted common shares to its executives, employees and non-employee trustees. Deferred compensation expenses was recorded by the company as a reduction to stockholders' equity. This amount was estimated based on the IPO price of $9 per share and will be charged to compensation expense on a straight-line basis over the vesting period of three years.

The options of the Predecessor were recorded based on the fair value method as prescribed in SFAS 123, *Accounting for Stock-Based Compensation*. As of September 30, 2003, the Company has determined that outstanding options do not have any value due to the estimated decline in fair value of the Company since the initial grant of options in 1999. The option plan was terminated prior to the consummation of the IPO on December 22, 2003.

(n) Comprehensive Income (Loss)

Comprehensive income (loss) represents net income (loss) and certain amounts reported directly in stockholders'/members' equity (deficit), such as net unrealized gain or loss on retained interests in securitizations and the change in the fair value of cash flow hedges. The Company has reported comprehensive income (loss) in the statements of changes in stockholders'/members' equity (deficit). Accumulated other comprehensive income (loss) reported in the statements of financial position as of December 31, 2003 and 2002, and September 30, 2003 and 2002, represents the accumulated unrealized gain on retained interests in securitizations and interest rate swaps accounted for as cash flow hedges.

(o) Income Taxes

The Company has elected to be treated as a real estate investment trust (hereafter "REIT") for federal income tax purposes. To maintain its status as a REIT, the Company must comply with the REIT provisions of the Internal Revenue Code of 1986, as amended (hereafter "IRC"). If the Company distributes 100% of its taxable income to its shareholders and satisfies the various REIT asset, income, stock ownership and other tests under the IRC, the Company generally will not be subject to federal income tax. If the Company fails to qualify as a REIT in any taxable year, it will be subject to federal income tax (including any applicable alternative minimum tax) on its taxable income at regular corporate rates. Even if the Company qualifies as a REIT, it may be subject to federal income tax and excise tax on its undistributed taxable income and may also be subject to state and local income taxes. The Company's subsidiary, Falcon Financial II, LLC is a taxable REIT subsidiary ("TRS") for federal income tax purposes and is fully taxable at normal corporate tax rates.

(p) Earnings (loss) per Share

The Company calculates basic earnings per share by dividing net income (loss) for the period by the weighted-average shares of its common stock outstanding for that period (net of unvested restricted shares). Diluted earnings per share takes into account the effect of dilutive instruments, including unvested restricted shares, using the average share price for the period in determining the number of incremental shares that are added to the weighted-average number of shares outstanding.

(q) Reclassifications

Certain items from prior years have been reclassified to conform with the 2003 classifications.

(r) Recent Accounting Developments

In June 2002, the FASB issued SFAS No. 146 "Accounting for Costs Associated with Exit or Disposal Activities." The statement specifies the accounting for certain employee termination benefits, contract termination costs and costs to consolidated facilities or relocate employees and is effective for exit and disposal activities initiated after December 31, 2002. Adoption of this statement did not have a material effect on the Company's financial condition or results of operations.

In November 2002, the FASB issued FASB Interpretation (FIN) No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." FIN No. 45 specifies the disclosures to be made about obligation under

certain issued guarantees and requires a liability to be recognized for the fair value of a guarantee obligation. The recognition and measurement provision of the interpretation apply prospectively to guarantees issued after September 30, 2002. Adoption of this interpretation did not have a material effect on the Company's financial condition or results of operations.

In January 2003, the FASB issued FASB Interpretation (FIN) No. 46 "Consolidation of Variable Interest Entities." FIN No. 46 requires a company to consolidate a variable interest entity (VIE) if the company has variable interests that give it a majority of the expected losses or a majority of the expected residual returns of the entity. Prior to FIN No. 46, VIEs were commonly referred to as SPEs. FIN No. 46, as amended by FIN No. 46-R "Effective Date of FASB Interpretation 46" which was released by FASB in October 2003, is effective for public companies in the first interim or annual period ending after December 15, 2003, if certain conditions are met. The Company must apply the standards of FIN No. 46 in its year end December 31, 2003 financial statements and will adopt FIN 46-R for quarter ended March 31, 2004. Adoption of this new accounting standard will not have a material effect on the Company's financial condition or results of operations.

In April 2003, the FASB issued SFAS Statement No. 149 "Amendment to Statement No. 133 on Derivative Instruments and Hedging Activities." This statement amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS Statement No. 133 Accounting for Derivative Instruments and Hedging Activities. The changes in SFAS Statement No. 149 improve financial reporting by requiring that contracts with comparable characteristics be accounted for similarly. Those changes will result in more consistent reporting of contracts as either derivatives or hybrid instruments. SFAS Statement No.149 is effective for contracts entered into or modified after June 30, 2003, except in certain instances detailed in the Statement, and hedging relationships designated after June 30, 2003. Except as otherwise stated in SFAS Statement No. 149, all provisions should be applied prospectively. Adoption of this statement did not have a material effect on our financial condition or results of operations.

In May 2003, the FASB issued SFAS Statement No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity" ("SFAS No. 150"). SFAS No. 150 clarifies the accounting for certain financial instruments with characteristics of both liabilities and equity and requires that those instruments be classified as liabilities in statements of financial position. Previously, many of these financial instruments were classified as equity. SFAS No. 150 is effective for all financial instruments entered into or modified after May 31, 2003 and is otherwise effective at the beginning of the first interim period after June 15, 2003. However, in October 2003, the Financial Accounting Standards Board elected to indefinitely defer implementation of certain standards of SFAS No. 150 relating to limited-life subsidiaries. We do not expect the adoption of this statement to have a material impact on the Company's results of operations, financial position or cash flows.

(3) Loans and Loans Held for Sale

Loans as of December 31, 2003 and loans held for sale at December 31, 2002 and September 30, 2003 and 2002 are summarized as follows:

		Loans Held for Sale		
	December 31, 2003	**December 31, 2002**	**September 30, 2003**	**September 30, 2002**
		(unaudited)		
Franchise mortgage loans	$ 127,846,080	$ 145,422,720	$ 105,861,254	$ 105,974,318
Less: Net deferred loan origination fees	(682,766)	(1,499,642)	(541,638)	(1,219,619)
Allowance for possible loan losses	(1,086,692)			
Loans, net	$ 126,076,622	$ 143,923,078	$ 105,319,616	$ 104,754,699

Loans receivable at December 31, 2003 are comprised of fixed-rate loans with interest rates ranging between 8.14% and 9.52%. Maturity dates range from February 1, 2011 to April 1, 2023 with 78.9% maturing during 2018. Two loans totaling approximately $9.6 million have balloon payments of approximately $4.0 million on February 1, 2011 and approximately $1.5 million on December 1, 2013. There are 17 borrowers located in 15 states. Approximately 33.13% of the principal balance of the loans are to three borrowers located in two states (Florida 22.1% and Virginia 11.03%). There are no other concentrations greater than 10% in any other state or to any individual borrower.

Loans held for sale at December 31, 2002 are comprised of fixed-rate loans with interest rates ranging between 8.875% and 10.48%. Maturity dates range from December 1, 2009 to January 1, 2023 with 48.9% maturing during 2017. There are 23 borrowers located in 16 states. Approximately 44.38% of the principal balance of the loans held for sale are to borrowers located in three states (New York 13.93%, Texas 19.92% and Colorado 10.53%). There are no other concentrations greater than 10% in any other state.

Loans held for sale at September 30, 2003 are comprised of fixed-rate loans with interest rates ranging between 8.14% and 9.47%. Maturity dates range from February 11, 2011 to April 1, 2023 with 85.54% maturing during 2018. There are 14 borrowers located in 13 states. Approximately 40.83% of the principal balance of the loans held for sale are to borrowers located in three states (New York 10.27%, Florida 17.24% and Virginia 13.32%). There are no other concentrations greater than 10% in any other state.

Loans held for sale at September 30, 2002 are comprised of fixed-rate loans with interest rates ranging between 8.75% and 10.48%. Maturity dates range from October 1, 2009 to October 1, 2017 with 62.9% maturing during 2017. There are 20 borrowers located in 14 states. Approximately 17.2% of the principal balance of the loans held for sale are to borrowers located in New York state. There are no other concentrations greater than 10% in any other state.

The Company originates franchise mortgage loans secured by existing car and truck dealerships, including real estate and improvements (real collateral), parts inventory, and blue-sky value (business asset collateral). Blue-sky, or franchise value, is an intangible asset that is a function of, among other things, the business reputation, brand strength, financial strength, and market share of the dealership. The Company also originates mortgage loans secured by real collateral. The Company's liens on business asset collateral may be subordinated in whole or in part to liens held by other lenders.

There were no loans or loans held for sale with unpaid principal or interest balances contractually past due or on non-accrual status as of December 31, 2003 and 2002 (unaudited) or September 30, 2003 and 2002.

As of December 31, 2003 and 2002 and September 30, 2003 and 2002, the allowance for possible loan losses was $1,086,692, $0, $0 and $0, respectively.

(4) Allowance for Possible Loan Losses

The Company establishes an allowance for possible loan losses to reserve for losses inherent in its loan portfolio. The following summarizes the activity in the allowance for possible loan losses for the period from December 22, 2003 through December 31, 2003:

Balance at December 22, 2003	$	
Provision for possible loan losses		1,086,692
Balance at December 31, 2003	$	1,086,692

(5) Derivative Instruments and Hedging Activities

The Company enters into forward starting interest rate swap transactions to mitigate the effect that changes in interest rates and credit spreads have on the forecasted issuance of long-term debt. In swap transactions, the Company will generally enter into an interest rate swap contract, receiving a floating rate of interest and paying a fixed rate of interest. The term of the swap contracts is determined by the duration of the forecasted long-term debt to be issued. These swaps are accounted for as cash flow hedges and changes in their fair value are recorded in other comprehensive income.

The Predecessor has entered into certain transactions (short sales and purchases, securities resale and repurchase agreements, and interest rate swaps) to mitigate the effect that changes in interest rates and credit spreads have on the fair value of its fixed rate loan portfolio held for sale. Periods of rising interest rates and widening credit spreads decrease the fair value of the loan portfolio held for sale. Generally, the Company entered into these transactions when the rate is locked on a pending loan just prior to the closing of the loan. The new loan is added to the pool of loans being held for sale and the pool is then reviewed to determine what, if any, additional hedging transaction is to be executed. Generally, the Predecessor shorted U.S. Treasuries and invested the proceeds in repurchase agreements

with Goldman, Sachs & Co. with U.S. Treasury notes as the underlying securities. In swap transactions, the Predecessor entered into an interest rate swap contract, receiving a floating rate of interest and paying a fixed rate of interest. The term of the swap contracts is determined by duration of the loans held for sale pool. The Predecessor has a contractual obligation to settle the repurchase and swap agreements with Goldman, Sachs & Co. at the current fair value on the repurchase date. These contracts have been recorded as free standing derivatives with changes in fair value recorded in earnings.

As of December 31, 2003, the Company had four forward starting interest rate swap contracts accounted for as cash flow hedges on which the Company pays fixed and received floating. The contracts had a total notional amount of $94,271,976 and a fair value of $389,783. There was no accrued interest on these contracts at December 31, 2003. The contracts had maturity dates ranging from April 1, 2014 to December 1, 2016. Fixed interest rates ranged from 4.045% to 4.815% and a floating rate of 1.12%.

As of September 30, 2003, the Predecessor had two interest rate swap contracts on which the Predecessor paid fixed and received floating. The contracts had a total notional amount of $70,000,000 and a fair value of $(433,170). There was no accrued interest on these contracts at September 30, 2003. The contracts had maturity dates ranging from October 1, 2008 to October 1, 2013. Fixed interest rates ranged from 3.356% to 4.458% and a floating rate of 1.16%. As of September 30, 2003, the Predecessor had cash collateral on deposit with Goldman, Sachs & Co. in the amount of $80,842, which is shown on the statement of financial position under the caption Due from Broker. These swaps were terminated on December 19, 2003 for a net payment of approximately $150,000.

As of December 31, 2002, the Predecessor had six repurchase contracts open with Goldman Sachs. The contracts had a total face value of $30,000,000 and a fair value of $32,047,500 (unaudited). These contracts had maturity dates ranging from May 15, 2007 to November 15, 2012 and paid interest at rates ranging from 0.6% to 0.9% (unaudited).

As of December 31, 2002, the Predecessor had shorted U.S. Treasuries with a face amount of $30,000,000 and a fair value of ($31,908,989) (unaudited). These treasury positions had maturity dates ranging from May 15, 2007 to November 15, 2012 and carried interest rates ranging from 3.0% to 5.0%.

As of December 31, 2002, the Predecessor had 13 interest rate swap contracts in which the Predecessor paid fixed and received float. The contracts had a total notional amount of $70,500,000 and a fair value of ($5,900,800) (unaudited). Accrued interest on these contracts totaled $847,900 at December 31, 2002 (unaudited). The contracts had maturity dates ranging from September 27, 2006 to September 3, 2012 (unaudited). Fixed interest rates ranged from 3.52% to 5.93% while floating rates ranged from 1.38% to 1.76% (unaudited).

As of September 30, 2002, the Predecessor had 13 interest rate swap contracts in which the Predecessor paid fixed and received float. The contracts had a total notional amount of $70,500,000 and a fair value of ($5,719,800). Accrued interest on these contracts totaled $478,700 at September 30, 2002. The contracts had maturity dates ranging from September 27, 2006 to September 3, 2012. Fixed interest rates ranged from 3.52% to 5.93% while floating rates ranged from 1.75% to 1.86%. As of September 30, 2002, the Predecessor had cash collateral relating to the outstanding swap contracts on deposit with Goldman, Sachs & Co. in the amount of $5,630,000, which is shown on the statement of

financial position under the caption Due from Broker. All of these interest rate swap contracts were settled during the year ended September 30, 2003.

As of September 30, 2002, the Predecessor had four repurchase contracts open with Goldman Sachs. The contracts had a total face value of $10,000,000 and a fair value of $11,262,500. These contracts had maturity dates ranging from May 15, 2007 to February 15, 2012 and paid interest at rates ranging from 1.25% to 1.375%. As of September 30, 2002, the Predecessor had a liability to Goldman, Sachs & Co. associated with its repurchase contracts of $663,273, which is shown on the statement of financial position under the caption Due to Broker. All of these repurchase contracts were settled during the year ended September 30, 2003.

As of September 30, 2002, the Company had shorted U.S. Treasuries with a face amount of $10,000,000 and a fair value of $11,160,729. These treasury positions had maturity dates ranging from May 15, 2007 to February 15, 2012 and carried interest rates ranging from 4.375% to 5.0%. All of these treasury positions were settled during the year ended September 30, 2003.

(6) Loan Securitization

Through a special purpose bankruptcy remote subsidiary, the Predecessor entered into securitization transactions that have qualified as sales for financial reporting purposes, resulting in off-balance sheet accounting treatment. The Company may retain rated and nonrated certificates issued in connection with the securitization transaction.

The table below summarizes the Predecessor's securitization transactions as of the date of the securitization and December 31, 2003:

	Falcon Trust Series 1999-1		Falcon Trust Series 2000-1		Falcon Trust Series 2001-1		Falcon Trust Series 2003-1	
	Securitization	**December 31, 2003**	**Securitization**	**December 31, 2003**	**Securitization**	**December 31, 2003**	**Securitization**	**December 31, 2003**
Principal balance of receivables	114,152,754	97,069,403	121,385,741	110,781,292	140,427,407	127,902,372	141,060,558	137,278,647
Proceeds received	115,093,026	N/A	131,162,936	N/A	138,565,191	N/A	145,464,590	N/A
Gains recorded	2,401,847	N/A	11,475,541	N/A	5,010,258	N/A	10,682,773	N/A
Rated bond retained, at fair value	1,464,790	2,054,037	1,528,854	N/A	2,435,074	N/A	2,983,560	N/A
Unrated bond retained, at fair value	1,645,392	1,140,252	1,720,018	1,123,955	3,065,452	1,229,460	2,448,063	1,691,432
Master servicing fee rate	0.065%	0.065%	0.065%	0.065%	0.065%	0.065%	0.055%	0.055%
Primary servicing rate	0.085%	0.085%	0.085%	0.085%	0.085%	0.085%	0.095%	0.095%
Trustee fee rate	0.010%	0.010%	0.010%	0.010%	0.010%	0.010%	0.010%	0.010%
Assumptions Used:								
Loss/Prepayment rate over transaction life	0.00%	3.24%	0.00%	3.10%	0.00%	5.80%	3.79%	5.88%
Discount Rates								
Rated retained interests	18.00%	14.37%	18.00%	N/A	18.00%	N/A	15.66%	N/A
Unrated retained interests	30.00%	18.09%	30.00%	18.80%	30.00%	18.00%	27.38%	18.20%

54

The table below summarizes the Company's securitization transactions as of the date of the securitization and December 31, 2002 (unaudited):

	Falcon Trust Series 1999-1		Falcon Trust Series 2000-1		Falcon Trust Series 2001-1	
	Securitization	**December 31, 2002**	**Securitization**	**December 31, 2002**	**Securitization**	**December 31, 2002**
Principal balance of receivables	114,152,754	101,924,389	121,385,741	114,874,237	140,427,407	135,745,712
Proceeds received	115,093,026	N/A	131,162,936	N/A	138,565,191	N/A
Gains recorded	2,401,847	N/A	11,475,541	N/A	5,010,258	N/A
Rated bond retained, at fair value	1,464,790	1,596,069	1,528,854	N/A	2,435,074	N/A
Unrated bond retained, at fair value	1,645,392	624,658	1,720,018	750,700	3,065,452	1,489,316
Master servicing fee rate	0.065%	0.065%	0.065%	0.065%	0.065%	0.065%
Primary servicing rate	0.085%	0.085%	0.085%	0.085%	0.085%	0.085%
Trustee fee rate	0.010%	0.010%	0.010%	0.010%	0.010%	0.010%
Assumptions Used:						
Loss/Prepayment rate over transaction life	0.00%	3.24%	0.00%	3.24	0.00%	4.33
Discount Rates						
Rated retained interests	18.00%	18.68%	18.00%	N/A	18.00%	N/A
Unrated retained interests	30.00%	24.60%	30.00%	24.73	30.00%	25.47%

The table below summarizes the Predecessor's securitization transactions as of the date of the securitization and September 30, 2003:

	Falcon Trust Series 1999-1		Falcon Trust Series 2000-1		Falcon Trust Series 2001-1		Falcon Trust Series 2003-1	
	Securitization	September 30, 2002	Securitization	September 30, 2002	Securitization	September 30, 2002	Securitization	September 30, 2002
Principal balance of receivables	114,152,754	97,909,734	121,385,741	111,488,738	140,427,407	128,760,718	141,060,558	138,032,710
Proceeds received	115,093,026	N/A	131,162,936	N/A	138,565,191	N/A	145,464,590	N/A
Gains recorded	2,401,847	N/A	11,475,541	N/A	5,010,258	N/A	10,682,773	N/A
Rated bond retained, at fair value	1,464,790	2,083,912	1,528,854	N/A	2,435,074	N/A	2,983,560	N/A
Unrated bond retained, at fair value	1,645,392	964,897	1,720,018	1,011,941	3,065,452	1,503,281	2,448,063	1,828,850
Master servicing fee rate	0.065%	0.065%	0.065%	0.065%	0.065%	0.065%	0.055%	0.055%
Primary servicing rate	0.085%	0.085%	0.085%	0.085%	0.085%	0.085%	0.095%	0.095%
Trustee fee rate	0.010%	0.010%	0.010%	0.010%	0.010%	0.010%	0.010%	0.010%
Assumptions Used:								
Loss/Prepayment rate over transaction life	0.00%	3.24%	0.00%	3.24%	0.00%	4.23%	3.79%	5.99%
Discount Rates								
Rated retained interests	18.00%	14.37%	18.00%	N/A	18.00%	N/A	15.66%	N/A
Unrated retained interests	30.00%	17.70%	30.00%	20.71%	30.00%	23.13%	27.38%	34.03%

55

The table below summarizes the Company's securitization transactions as of the date of the securitization and September 30, 2002:

	Falcon Trust Series 1999-1		Falcon Trust Series 2000-1		Falcon Trust Series 2000-1	
	Securitization	September 30, 2002	Securitization	September 30, 2002	Securitization	September 30, 2002
Principal balance of receivables	114,152,754	103,068,168	121,385,741	115,838,334	140,427,407	137,040,755
Proceeds received	115,093,026	N/A	131,162,936	N/A	138,565,191	N/A
Gains recorded	2,401,847	N/A	11,475,541	N/A	5,010,258	N/A
Rated bond retained, at fair value	1,464,790	1,982,992	1,528,854	2,042,238	2,435,074	N/A
Unrated bond retained, at fair value	1,645,392	1,026,316	1,720,018	1,047,229	3,065,452	1,409,418
Master servicing fee rate	0.065%	0.065%	0.065%	0.065%	0.065%	0.065%
Primary servicing rate	0.085%	0.085%	0.085%	0.085%	0.085%	0.085%
Trustee fee rate	0.010%	0.010%	0.010%	0.010%	0.010%	0.010%
Assumptions Used:						
Loss/Prepayment rate over transaction life	0.00%	3.24%	0.00%	3.24%	0.00%	4.23%
Discount Rates						
Rated retained interests	18.00%	14.33%	18.00%	13.74%	18.00%	N/A
Unrated retained interests	30.00%	17.70%	30.00%	20.71%	30.00%	23.13%

At December 31, 2003, key economic assumptions and sensitivity of the current fair value of retained interests to an immediate 10% and 20% adverse change in those assumptions are as follows:

	Falcon Trust Series 1999-1 Adverse Impact of		Falcon Trust Series 2000-1 Adverse Impact of		Falcon Trust Series 2001-1 Adverse Impact of		Falcon Trust Series 2003-1 Adverse Impact of	
	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change
Impact due to adverse change in loss/prepayment rates:								
Adjusted loss rate	3.55%	3.86%	3.40%	3.67%	6.39%	6.97%	6.48%	7.06%
Impact on fair value:								
Rated retained interests	(1,107)	(2,028)	N/A	N/A	N/A	N/A	N/A	N/A
Unrated retained interests	(48,006)	(92,444)	(39,971)	(76,895)	(452,307)	(547,418)	(165,390)	(320,295)
Impact due to adverse change in discount rates:								
Rated retained interests	15.80%	17.24%	N/A	N/A	N/A	N/A	N/A	N/A
Impact on fair value	(169,249)	(318,936)	N/A	N/A	N/A	N/A	N/A	N/A
Unrated retained interests	19.90%	21.71%	20.68%	22.56%	19.8%	21.6%	20.01%	21.83%
Impact on fair value	(91,416)	(170,004)	(88,554)	(163,324)	(108,079)	(200,084)	(125,044)	(230,056)

At December 31, 2002, key economic assumptions and sensitivity of the current fair value of retained interests to an immediate 10% and 20% adverse change in those assumptions are as follows (unaudited):

	Falcon Trust Series 1999-1 Adverse Impact of		Falcon Trust Series 2000-1 Adverse Impact of		Falcon Trust Series 2001-1 Adverse Impact of	
	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change
Impact due to adverse change in loss/prepayment rates:						
Adjusted loss rate	3.56%	3.89%	3.57%	3.89%	4.76%	5.20%
Impact on fair value:						
Rated retained interests	0	0	N/A	N/A	N/A	N/A
Unrated retained interests	(372,287)	(744,574)	(397,557)	(795,113)	(608,110)	(1,216,220)
Impact due to adverse change in discount rates:						
Rated retained interests	20.71%	22.78%	N/A	N/A	N/A	N/A
Impact on fair value	(157,650)	(292,7218)	N/A	N/A	N/A	N/A
Unrated retained interests	27.34%	30.14%	27.47%	30.30%	28.32%	31.23%
Impact on fair value	(51,200)	(93,520)	(72,694)	(117,003)	(122,888)	(225,828)

At September 30, 2003, key economic assumptions and sensitivity of the current fair value of retained interests to an immediate 10% and 20% adverse change in those assumptions are as follows:

	Falcon Trust Series 1999-1 Adverse Impact of		Falcon Trust Series 2000-1 Adverse Impact of		Falcon Trust Series 2001-1 Adverse Impact of		Falcon Trust Series 2003-1 Adverse Impact of	
	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change
Impact due to adverse change in loss/prepayment rates:								
Adjusted loss rate	3.56%	3.89%	3.56%	3.89%	4.65%	5.08%	6.59%	7.19%
Impact on fair value:								

	Falcon Trust Series 1999-1 Adverse Impact of		Falcon Trust Series 2000-1 Adverse Impact of		Falcon Trust Series 2001-1 Adverse Impact of		Falcon Trust Series 2003-1 Adverse Impact of	
Rated retained interests	(6,047)	(13,840)	N/A	N/A	N/A	N/A	N/A	N/A
Unrated retained interests	(67,955)	(134,867)	(36,726)	(73,705)	(23,717)	(47,399)	(39,478)	(79,841)
Impact due to adverse change in discount rates:								
Rated retained interests	15.73%	17.16%	N/A	N/A	N/A	N/A	N/A	N/A
Impact on fair value	(169,907)	(319,777)	N/A	N/A	N/A	N/A	N/A	N/A
Unrated retained interests	19.97%	22.24%	23.11%	25.51%	25.64%	28.16%	37.64%	41.23%
Impact on fair value	(104,985)	(191,088)	(101,744)	(184,227)	(138,546)	(251,885)	(159,588)	(232,144)

At September 30, 2002, key economic assumptions and sensitivity of the current fair value of retained interests to an immediate 10% and 20% adverse change in those assumptions are as follows:

	Falcon Trust Series 1999-1 Adverse Impact of		Falcon Trust Series 2000-1 Adverse Impact of		Falcon Trust Series 2001-1 Adverse Impact of	
	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change	10 Percent Change	20 Percent Change
Impact due to adverse change in loss/prepayment rates:						
Adjusted loss rate	3.56%	3.89%	3.56%	3.89%	4.65%	5.08%
Impact on fair value:						
Rated retained interests	(5,269)	(12,058)	(31,036)	(78,108)	N/A	N/A
Unrated retained interests	(57,629)	(114,377)	(30,157)	(60,521)	(19,055)	(38,081)
Impact due to adverse change in discount rates:						
Rated retained interests	15.76%	17.20%	15.11%	16.50%	N/A	N/A
Impact on fair value	(170,776)	(320,210)	(184,676)	(343,761)	N/A	N/A
Unrated retained interests	19.19%	22.24%	23.11%	25.51%	25.65%	28.16%
Impact on fair value	(105,414)	(191,524)	(101,635)	(184,095)	(136,122)	(247,250)

As required by SFAS 140, the effect of two negative changes in each of the key assumptions used to determine the fair value of retained interests must be disclosed. The negative effect of each change in each assumption must be calculated independently, holding all other assumptions constant. Because key assumptions may not in fact be independent, the net effect of simultaneous adverse changes in the key assumptions may be less than the sum of the individual effects shown above.

In December 2001, the Predecessor sold 49% of its unrated retained interest in the 2001-1 Trust to a third party. The Predecessor received proceeds of $1,586,993 and realized a gain of $155,707. In August 2002, the Predecessor sold 100% of its rated retained interest in the 2001-1 Trust to Goldman, Sachs & Co. The Company received proceeds of $2,321,929 and realized a loss of $19,238.

In September 2001, the Predecessor sold 49% of its unrated retained interest in the 1999-1 Trust to a third party. The Predecessor received proceeds of $977,861 and realized a gain of $309,440.

In September 2001, the Predecessor sold 49% of its unrated retained interest, in the 2000-1 Trust to a third party. The Predecessor received proceeds of $989,423 and realized a gain of $273,138.

In March 2002, a delinquency was experienced in the 2001-1 Trust for a loan with an unpaid principal balance of approximately $2.8 million. The loan defaulted in March 2002. In July 2002, the Predecessor estimated that there would be an other than temporary reduction in the aggregate cash flows that the Predecessor expects to receive from the 2001-1 Trust for its unrated retained interest. Accordingly, the Predecessor charged $178,251 to expense which was the amount considered to be other than temporary decline in the Company's fair value of the unrated retained interest. This estimated reduction in aggregate cash flows was based on management's assessment of the amounts it would ultimately collect on the defaulted loan.

In October 2002, the Predecessor sold 100% of its rated retained interest in the 2000-1 Trust to a third party. The Predecessor received proceeds of $2,015,402 and realized a gain of $597,609.

In February 2003, the Predecessor sold 100% of its rated retained interest in the 2003-1 Trust to a third party. The Predecessor received proceeds of $2,983,560 and realized a gain of $253,265

In August 2003, a delinquency was experienced in the 2003-1 Trust for a loan with an unpaid principal balance of approximately $9.5 million. The loan defaulted in September 2003 and the Predecessor estimated that there would be an other than temporary reduction in the aggregate cash flows that the Predecessor expects to receive from the 2003-1 Trust for its unrated retained interest. Accordingly, the Predecessor charged $422,477 to expense, which was the amount considered to be other than temporary decline in the Predecessor's fair value of the unrated retained interest. This estimated reduction in aggregate cash flows was based on management's assessment of the amounts it would ultimately collect on the defaulted loan.

In October 2003, Moody's downgraded the Class A-1 and A-2 certificates in the 2003 securitization from Aaa to Aa1, the Class B certificates from Aa2 to Aa3, the Class C certificates from A2 to A3, the Class D certificates from Baa2 to Baa3, the Class E certificates from Ba2 to Ba3, and the Class F certificates from B3 to Caa2. In November 2003, Moody's further downgraded the Class A-1 and A-2 certificates in this securitization from Aa1 to Aa2, the Class B certificates from Aa3 to A1, the Class C certificates from A3 to Baa1, the Class D certificates from Baa3 to Ba1, the Class E certificates from Ba3 to B3, and the Class F certificates from Caa2 to Caa3. In November 2003, Fitch Ratings downgraded the Class E certificates in this securitization from BB to B+ and the Class F certificates

from B to CCC. Additionally, Fitch Ratings placed the Class B, C, D, E and F certificates on rating watch for potential downgrade. Fitch Ratings affirmed the Class A certificates at AAA.

In January 2004, a delinquency was experienced in the 2001-1 Trust for a loan with an unpaid principal balance of approximately $2.5 million. The loan defaulted in January 2004 and the Company estimated that there would be an other than temporary reduction in the aggregate cash flows that the Company expects to receive from the 2001-1 Trust for its unrated retained interest. While this delinquency resulted in an estimated $0.2 million reduction in the value of the retained interest on the 2001-1 Trust it was offset by unrealized gains in accumulated other comprehensive income for the 2001-1 transaction and accordingly, did not result in a charge to the statement of operations. This estimated reduction in aggregate cash flows was based on management's assessment of the amounts it would ultimately collect on the defaulted loan. The real estate collateral for this loan was forclosed upon subsequent to December 31, 2003.

For the 1999-1 Trust, 2000-1 Trust, 2001-1 Trust and the 2003-1 Trust, the Master Servicer fee rate was 0.065% (0.055% on the 2003-1 Trust), the Primary Servicer fee rate was 0.085% (0.095% on the 2003-1 Trust) and the Trustee fee rate was 0.010%. The Master Servicer services are outsourced to a third party.

The activity related to the Company's and the Predecessor's retained interests for the three months ended December 31, 2003 and 2002 and the years ended September 30, 2003, 2002 and 2001 are as follows:

	Three Months ended December 31, 2003	**Three Months ended December 31, 2002**	**Year ended September 30, 2003**	**Year ended September 30, 2002**	**Year ended September 30, 2001**
		(unaudited)			
Balance at beginning of period	$ 7,347,881	$ 7,508,193	$ 7,508,193	$ 4,793,617	$ 6,457,822
Addition recognized in securitization, at allocated basis			4,968,464	5,229,138	
Interest income recorded	375,517	237,338	1,377,052	1,475,891	1,183,889
Cash received	(360,589)	(297,397)	(1,479,468)	(1,483,343)	(1,391,275)
Cash received from sales to third parties		(2,015,402)	(4,998,962)	(3,908,922)	(1,967,282)
Income recognized from dispositions		597,609	850,874	136,469	582,578
Fair value adjustments, net of other than temporary decline in value	(123,673)	(548,715)	(878,272)	1,265,343	(72,115)
Balance at end of period	$ 7,239,136	$ 5,481,626	$ 7,347,881	$ 7,508,193	$ 4,793,617

The retained interest balance of $7,239,136, $5,481,626 (unaudited), $7,347,881 and $7,508,193 as at December 31,2003 and 2002 and September 30, 2003 and 2002 includes $180,703, $138,785 (unaudited), $129,653 and $100,135 of accrued interest receivable, respectively.

(7) Borrowings

Borrowings as of December 31, 2003 and 2002 are summarized as follows:

2003:	Balance	Total Credit Line	Interest rate	Maturity
Warehouse line of credit	$ 53,475,879	$ 150,000,000	floating	10/1/04
Senior subordinated loan		N/A	N/A	N/A
Junior subordinated loan		N/A	N/A	N/A
Interest capitalization notes		N/A	N/A	N/A
	$ 53,475,879			

2002 (unaudited):	Balance	Total Credit Line	Interest rate	Maturity
Warehouse line of credit	$ 133,566,739	$ 150,000,000	floating	10/27/03
Senior subordinated loan	18,387,845	19,300,000	12.00%	10/1/04
Junior subordinated loan	500,000	500,000	12.00%	10/1/04
Interest capitalization notes	1,468,132	N/A	12.00%	10/1/04
	$ 153,922,716			

Borrowings as of September 30, 2003 and 2002 are summarized as follows:

2003:	Balance	Total Credit Line	Interest rate	Maturity
Warehouse line of credit	$ 97,317,254	$ 150,000,000	floating	10/1/04
Senior subordinated loan	8,794,000	19,300,000	12.00%	10/1/04
Junior subordinated loan	500,000	500,000	12.00%	10/1/04
Interest capitalization notes	973,940	N/A	12.00%	10/1/04
	$ 107,585,194			

2002:	Balance	Total Credit Line	Interest rate	Maturity
Warehouse line of credit	$ 97,342,078	$ 150,000,000	floating	10/27/03
Senior subordinated loan	16,579,820	19,300,000	12.00%	10/1/04
Junior subordinated loan	500,000	500,000	12.00%	10/1/04
Interest capitalization notes	1,333,883	N/A	12.00%	10/1/04
	$ 115,755,781			

The Predecessor entered into a $150 million Revolving Warehouse Financing Agreement dated January 7, 1998 (the "Warehouse Loan Agreement") with ABN AMRO Bank, N.V., as lender, and SunAmerica Life Insurance Company or SALIC (an affiliate of SunAmerica, Inc.), as guarantor (collectively, the "Lenders"), solely for the purpose of originating loans. SALIC, along with Goldman Sachs Mortgage Company (an affiliate of Goldman, Sachs & Co.), as a result of a participation agreement between two entities, are the guarantors of the Revolving Warehouse Financing Agreement. As guarantors, each of the entities was paid fees of $334,253, $415,529 (unaudited), $1,166,204, $1,101,658 and $622,891 for the period from October 1, 2003 to December 21, 2003, for the period from October 1, 2002 to December 31, 2002 and for the fiscal years ended September 30, 2003, 2002 and 2001, respectively. The fees are shown on the statements of operations within the caption "interest expense related party." The maturity date has been extended to October 1, 2004. This credit facility is collateralized by the loans held for

sale. The Company is required to make prepayments under the

warehouse facility under certain circumstances. Among other things, in the event that a customer defaults on a scheduled loan payment that is not cured within 30 days, such loan will be treated as a defaulted receivable and the Company will be required to prepay the outstanding principal amount of the borrowings incurred under the warehouse facility in respect of such defaulted receivable. Interest was calculated using a 30 day commercial paper rate plus 200 basis points (300 basis points prior to December 22, 2003) (which includes amounts paid to the guarantors as described above.) The interest rates as of December 31, 2003 and 2002, September 30, 2003, 2002 and 2001 were 3.09%, 4.45% (unaudited), 4.06%, 4.77% and 5.40%, respectively.

The Predecessor entered into a $19.3 million Amended and Restated Senior Subordinated Loan Agreement dated January 7, 1998, with Goldman Sachs Mortgage Company and SALIC. The agreement provides for a $5.0 million working capital loan, a $2.0 million hedge loan and $12.3 million for loan originations. As of December 31, 2003, December 31, 2002, September 30, 2003 and 2002, there was $0.0 million, $4.7 million (unaudited), $0.8 million and $5.0 million outstanding used for working capital purposes, $0.0 million, $2.0 million (unaudited), $0.0 million and $2.0 million outstanding for hedge purposes and $0.0 million, $11.7 million (unaudited), $8.0 million and $9.6 million outstanding for loan originations, respectively. The interest rate on the senior subordinated loan is 12%, with 9% payable in cash and 3% accrued and capitalized. This loan was paid-in-full on December 22, 2003.

The Predecessor entered into a $0.5 million Junior Subordinated Loan Agreement dated April 19, 1999 with Falcon Auto Venture, LLC. The agreement provides for a $0.5 million working capital loan. As of December 31, 2003, December 31, 2002, September 30, 2003 and 2002, the outstanding balance was $0.0 million, $0.5 million (unaudited), $0.5 million and $0.5 million, respectively. The interest rate on the junior subordinated loan is 12%, with 9% payable in cash and 3% accrued and capitalized. This loan was paid-in-full on December 22, 2003 and the loan terminated.

The interest capitalization notes represent the 3% interest capitalization on the senior subordinated loan and the junior subordinated loan referred to above. Interest on the capitalization notes is also at a rate of 12%, with 9% payable in cash and 3% accrued and capitalized. These notes were paid-in-full on December 22, 2003 and the loan terminated.

The Warehouse Loan Agreement requires that the Company maintain certain financial covenants related to aggregate indebtedness, net income, net worth, leverage ratio, capital expenditures and lease commitments. In addition, the Warehouse Loan Agreement also specifies various events ("Termination Events") that would allow the Lenders to terminate the warehouse facility in its entirety should one of these events occur, including, among other things, (i) a material adverse change in the Company's business, financial condition or prospects or (ii) a downgrade or other impairment of the rating of any notes issued in the Predecessor's securitization transactions. In October 2003 and November 2003, the notes issued in the Predecessor's Falcon Trust Series 2003-1 securitization were downgraded by the ratings agencies. The Predecessor received a waiver from the Lenders for this Termination Event.

In October 2003, the Predecessor entered into an agreement with respect to its warehouse line of credit that, among other things, (i) extended the facility to May 1, 2004,(ii) required that the Company obtain the approval of certain lenders prior to the funding of any new loan origination, and (iii) imposed a new prepayment requirement based on the aggregate present value of the Predecessor's loan portfolio. Specifically, in the event that certain lenders determine that the product of the advance rate and the aggregate present value of the Company's loan portfolio is less that the aggregate

outstanding principal and accrued interest under the warehouse facility, then the Company will be required upon two business days' notice to prepay amounts borrowed under the warehouse facility in such amount as is necessary to eliminate such deficiency.

In November 2003, the Predecessor entered into an amendment of the warehouse line of credit that, among other things. (i) extended the facility until October 1, 2004, (ii) required the payment of certain fees, including a fee of $1.5 million on the date of the amendment, $3 million if the warehouse facility is not prepaid in full and terminated prior to May 1, 2004, and $1.5 million if the warehouse facility is not prepaid in full and terminated prior to October 1, 2004,(iii) in the case of loans made by the Company in an amount of $10 million or more, reduced the advance rate to 70% (subject to certain additional amounts if the Company's borrowings under the warehouse facility exceeds $80 million), and (iv) reduced the maximum principal amount of the Company's loans that may be attributable to one customer from less than $20 million to less than $15 million. In addition, the amendment provided that, subject to the successful completion of the initial public offering referred to above,

(i) the interest rate of the facility will be calculated using a 30-day commercial paper rate plus 200 basis points (250 basis points on and after May 1, 2004), a decrease from 300 basis points over 30-day commercial paper, (ii) should certain members of executive management of the Company cease to be employed by the Company for any reason other than death, disability or incapacity, the Company will be prohibited from making additional borrowings under the warehouse facility, (iii) the advance rate under the facility will be reduced from 92% of the principal amount of eligible loans to 80%, and (iv) the facility will be available for working capital purposes to the extent that a voluntary prepayment is made with the proceeds of the initial public offering.

In addition, effective December 22, 2003 the Company is required under the warehouse credit line to maintain a ratio of consolidated total debt to consolidated net worth not in excess of 5:1, a consolidated net worth of not less than 80% of the net proceeds of our IPO plus 75% of net proceeds of any subsequent issuance of the Company's equity securities, and consolidated net income as of the end of any fiscal quarter commencing with the second fiscal quarter of 2004 of not less than a loss of $500,000. As of the end of the first fiscal quarter of 2004, the Company's consolidated net income is not permitted to be less than a loss of $2 million. The Company generally may not maintain indebtedness outside the warehouse credit line after our IPO other than indebtedness of up to $10 million to fund obligations under the Company's hedging arrangements, purchase money indebtedness for the acquisition of assets not in excess of $1.0 million, indebtedness in connection with the Company's securitization transactions and certain capital leases. The warehouse credit line also limits the Company's consolidated capital expenditures to not more than $500,000 in any fiscal year. In March 2004, the Company entered into an amendment of the warehouse line of credit that, among other things, allows for the funding of variable interest rate loans by the warehouse line of credit.

(8) Equity Incentive and Option Plan

In November 2003, the Company adopted the 2003 Equity Incentive Plan to provide incentives to employees, non-employee trustees and other service providers to stimulate their efforts toward the Company's continued success, long-term growth and profitability and to attract, reward and retain key personnel. The plan approved 725,658 restricted common shares reserved for issuance, of which 318,300 were issued immediately prior to the closing of the IPO, with the remaining 407,358 shares available for future issuance. The 318,300 shares issued were valued at the IPO price of $9 per share and recorded in equity under the caption of unearned compensation. The shares vest over three years and will be amortized into the statement of operations as compensation expense ratably over the vesting period.

In September 1999, the Predecessor adopted the Falcon Financial, LLC Option Plan. The Predecessor has granted certain employees options, which generally expire 10 years from the grant date, to purchase membership interests in the Predecessor at prices not less than the market value of the membership interests on the grant date. Option exercise prices were determined by reference to comparable public company market values and earnings multiples. Options vested at a rate of 20% per year beginning one year after the date of hire. The Predecessor had not incurred an expense associated with the option plan for the period October 1, 2003 to December 21, 2003, the three months ended December 31, 2002 (unaudited), and for the years ended September 30, 2003, 2002 and 2001. The plan was terminated prior to the consummation of the IPO on December 22, 2003 and through that date no options had been exercised.

(9) Commitments and Contingencies

(a) Financial Instruments With Off-Balance Sheet Risk

The Company's financial instruments with off-balance sheet risk were limited to fixed-rate mortgage loan origination commitments with total contractual amounts of $2.2 million as of December 31, 2003. These instruments involve elements of credit risk and interest rate risk in addition to the amounts recognized in the statements of financial position. The contractual amounts represent the Company's maximum potential exposure to credit loss but do not necessarily represent future cash requirements since certain commitments may expire without being funded. Loan commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee by the customer. Commitments are subject to the Company's credit approval process, including a case-by-case evaluation of the customer's creditworthiness and related collateral requirements. The Company collected cash deposits in connection with these commitments of $19,534, $100,000 (unaudited), $178,333 and $183,588 as of December 31, 2003 and 2002, and September 30, 2003 and 2002, respectively.

(b) Lease Commitments

As of December 31, 2003, the Company was obligated under noncancelable operating lease agreements for office space and computer equipment. The future minimum lease payments under these lease agreements at December 31, 2003 were:

2004	$	188,649
2005		198,453
2006		208,248

2007	218,049
2008	227,853
Thereafter	807,276
	$ 1,848,528

Rent expense for the period October 1, 2003 to December 21, 2003, the period December 22, 2003 to December 31, 2003, for the three months ended December 31, 2002 and for the years ended September 30, 2003, 2002 and 2001 was $50,428, $5,372, $58,663 (unaudited), $233,840, $204,533 and $165,868, respectively.

(c) The Company has entered into employment agreements with three members of senior management. The agreements range in term from two to three years, subject to additional one year renewals. The future minimum salary expense relating to these agreements is $900,000, $900,000 and $750,000 for the years ended December 31, 2004, 2005 and 2006, respectively.

(10) Fair Value of Financial Instruments

The information presented below is required by SFAS *No.* 107, *Disclosure About Fair Value of Financial Instruments*. These amounts represent estimates of fair value of financial instruments at a point in time. Significant estimates using available market information and appropriate valuation methodologies were used for the purpose of this disclosure. The estimates are not necessarily indicative of the amounts the Company could realize in a current market exchange, and the use of different market assumptions or methodologies could have a material effect on the estimated fair value amounts.

The following is a summary of the carrying amounts and estimated fair values of the Company's financial assets and liabilities as of December 31, 2003 and 2002:

	2003		2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
			(unaudited)	
Financial assets:				
Cash and cash equivalents	$ 25,645,578	$ 25,645,578	$ 610,430	$ 610,430
Loans, net	126,076,622	132,533,452	143,923,078	155,638,417
Securities purchased under resale agreements			32,047,500	32,047,500
Retained interests in loans securitizations	7,239,136	7,239,136	5,481,626	5,481,626
Due from broker			6,440,000	6,440,000
Interest rate swap contracts	389,783	389,783		
Accrued interest receivable	994,821	994,821	1,188,023	1,188,023
Restricted cash	2,657,660	2,657,660	1,974,462	1,974,462
Financial liabilities:				
Borrowings	$ 53,475,879	$ 53,475,879	$ 133,566,739	$ 133,566,739
Borrowings related party			20,355,977	20,355,977
Securities sold, but not yet purchased			31,908,989	31,908,989
Accrued interest payable	255,707	255,707	174,556	174,556
Accrued interest payable related party			1,855,829	1,855,829
Due to broker			1,699,778	1,699,778
Customer deposits	140,276	140,276	542,665	542,665
Holdback of loan proceeds	2,657,660	2,657,660	1,974,462	1,974,462

	2003		2002	
Interest rate swap contracts			5,900,800	5,900,800

The following is a summary of the carrying amounts and estimated fair values of the Company's financial assets and liabilities as of September 30, 2003 and 2002:

	2003		2002	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	$ 492,198	$ 492,198	$ 246,932	$ 246,932
Loans held for sale, net	105,319,616	111,638,793	104,754,699	113,281,731
Securities purchased under resale agreements	0	0	11,262,500	11,262,500
Retained interests in loans securitizations	7,347,881	7,347,881	7,508,193	7,508,193
Due from broker	80,842	80,842	5,630,000	5,630,000
Accrued interest receivable	624,199	624,199	992,029	992,029
Restricted cash	2,864,540	2,864,540	1,984,774	1,984,774
Financial liabilities:				
Borrowings	$ 97,317,254	$ 97,317,254	$ 97,342,078	$ 97,342,078
Borrowings related party	10,267,940	10,267,940	18,413,703	18,413,703
Securities sold, but not yet purchased	0	0	11,160,729	11,160,729
Accrued interest payable	82,307	82,307	139,091	139,091
Accrued interest payable related party	289,414	289,414	1,185,483	1,185,483
Due to broker	0	0	663,273	663,273
Customer deposits	389,439	389,439	643,458	643,458
Holdback of loan proceeds	2,864,540	2,864,540	1,984,774	1,984,774
Interest rate swap contracts	433,170	433,170	5,719,800	5,719,800

The following paragraphs describe the valuation methods used by the Company to estimate fair values of its financial instruments:

(a) Securities Purchased Under Resale Agreements

The fair values are based on market prices or securities dealers' estimated prices received from Goldman, Sachs & Co.

(b) Loans, Net

The fair values of loans are estimated by reference to current secondary market prices for similar loans, as well as estimates derived from information received from Goldman, Sachs & Co.

(c) Retained Interests in Loan Securitizations

The fair value of the retained interests is based on the present value of the estimated expected future cash flows received by the Company after being released by the securitization trust, using a discount rate commensurate with the risks involved.

(d) Securities Sold, But Not Yet Purchased

The fair values are based on the quoted market prices of the underlying securities received from Goldman, Sachs & Co.

(e) Interest Rate Swap Contracts

The fair values are based on securities dealers' market prices received from Goldman, Sachs & Co.

(f) Borrowings

Carrying value was deemed to approximate fair value because the rate and terms of debt existing as of the balance sheet date was comparable to those that the Company would currently establish for new debt with similar collateral, maturity and terms.

(g) Other Financial Instruments

The other financial assets and liabilities shown in the preceding table have fair values which approximate the respective carrying amounts. This is because cash and cash equivalents, accrued interest receivable and payable, due from/to broker and customer deposits are either payable on demand or have short-term maturities and present relatively low credit risk and interest rate risk.

(11) Related Party Transactions

The Company is involved in significant financing, risk management and other transactions, and the Predecessor had significant related party balances, with Goldman, Sachs & Co. (an affiliate of MLQ Investors, LP), SunAmerica, Inc. and Falcon Auto Venture, LLC, both directly and indirectly through affiliates and subsidiaries of the entities. The Company enters into these transactions in the ordinary course of business and believes that the terms of these transactions are on market terms that could be obtained from unrelated third parties. As of December 22, 2003 after the IPO transaction, the aforementioned related parties are no longer considered related parties as their ownership of the Company has been significantly reduced (less than 5%).

The following table sets forth the related party assets and liabilities included in the respective captions on the Statement of Financial Position at December 31, 2002, September 30, 2003 and 2002.

The amounts reflect the related party transactions with Goldman, Sachs & Co., except where otherwise indicated and are as follows:

	December 31, 2002	September 30, 2003	September 30, 2002
	(unaudited)		
Securities purchased under resale agreements	$ 32,047,500	$	$ 11,262,500
Due from broker	6,440,000	80,842	5,630,000
Borrowings ($9,906,277 and $543,423 at December 31, 2002, $4,856,014 and $555,913 at September 30, 2003 and $8,937,213 and $539,278 at September 30, 2002 related to SunAmerica, Inc. and Falcon Auto Venture, LLC respectively)	20,355,977	10,267,940	18,413,703
Securities sold, but not yet purchased	31,908,989		11,160,729
Accrued interest payable ($241,168 and $4,201 at December 31, 2002, $142,628 and $4,159 at September 30,2003 and $175,028 and $4,034 at September 30, 2002 related to SunAmerica, Inc. and Falcon Auto Venture, LLC, respectively)	1,855,829	289,414	1,185,483
Due to broker	1,690,778		663,273
Interest rate swap contracts	5,900,800	433,170	5,719,800

Included in the Statement of Operations are revenues and expenses resulting from various financing, capital markets transactions and loan sales transactions. The following table sets forth the related party revenues and expenses included in the respective captions on the Statement of Operations for the period from October 1, 2003 to December 31, 2003, the three months ended December 31,

2002 and for the years ended September 30, 2003, 2002 and 2001. The amounts reflect the related party transactions with Goldman, Sachs & Co., except where otherwise indicated and are as follows:

	Period from October 1, 2003 to December 21, 2003	Three months ended December 31, 2002	Year ended September 30,		
			2003	2002	2001
		(unaudited)			
Interest income on securities purchased under resale agreements	$	$ 46,136	$ 182,892	$ 122,346	$ 759,587
Gain on sale of loans-fee expense			(1,414,936)	(1,434,274)	
Loss on sale of retained interests net of other than temporary decline in value				(19,238)	
Change in value of interest rate swap contracts	283,170	(775,441)	(529,094)	(4,963,311)	(6,826,068)
Gain (loss) on securities sold, but not yet purchased		(1,033,025)	1,079,799	(857,174)	(1,403,183)
Interest expense on borrowings ($675,739 and $16,580 for the period from October 1, 2003 to December 21, 2003, $475,524 and $13,553 for the three months ended December 31, 2002, $1,800,037 and $66,535 in fiscal 2003, $1,876,102 and $63,548 in fiscal 2002 and $1,135,724 and $38,121 in fiscal 2001 related to SunAmeria, Inc. and Falcon Auto Venture, LLC, respectively)	964,602	1,368,058	3,666,609	3,815,752	2,309,569
Interest expense on securities sold,but not yet repurchased		181,671	1,252,746	503,624	1,161,018
Facility fee expense ($228,125 for the period from October 1, 2003 to December 21, 2003, $46,875 for the three months ended December 31, 2002, $187,500 in fiscal 2003, $192,500 in fiscal 2002 and $187,500 in fiscal 2001, related to SunAmerica, Inc.)	456,250	93,750	375,000	385,000	375,000

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None

ITEM 9A. CONTROLS AND PROCEDURES

As of December 31, 2003, our principal executive officer and our principal financial officer have performed an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) of the Securities Exchange Act of 1934, or Exchange Act, and concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission, or SEC, rules and forms. The officers have also concluded that there were no significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrections with regard to significant deficiencies and material weaknesses. There have been no significant changes in our internal controls or in other factors which could significantly affect internal controls subsequent to December 31, 2003.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information required by this item regarding trustees and executive officers is hereby incorporated by reference to the material appearing in the Proxy Statement for the Annual Shareholders Meeting to be held in 2004 (the "Proxy Statement") under the captions "Election of Trustees (Proposal 1)," "Executive Officers," "Meetings and Committees of the Board of Trustees" and "Executive Compensation and Other Information." The information required by this item regarding compliance with Section 16(a) of the Exchange Act is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption "Section 16(a) Beneficial Ownership Reporting Compliance."

ITEM 11. EXECUTIVE COMPENSATION

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the captions "Meetings and Committees of the Board of Trustees," and "Executive Compensation and Other Information."

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information regarding security ownership of certain beneficial owners and management required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption "Security Ownership of Certain Beneficial Owners and Management and Related Shareholder Matters."

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption "Certain Relationships and Related Transactions."

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES.

The information required by this item is hereby incorporated by reference to the material appearing in the Proxy Statement under the caption "Independent Public Accountants."

ITEM 15. EXHIBITS, CONSOLIDATED FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a)(1) The following Consolidated Financial Statements of and report of independent public accountants for Falcon Financial Investment Trust are included in Item 8 of this Form 10-K:

Independent Auditors' Report

Consolidated Statements of Financial Position

Consolidated Statements of Operations

Consolidated Statements of Changes in Stockholders'/Members' Equity (Deficit) and Comprehensive Income (Loss)

Consolidated Statements of Cash Flows

Notes to Consolidated Statements of Financial Statements

(a)(2) The following consolidated financial statement schedules are filed as part of this report and attached hereto as page S-1 and S-2:

Schedule IV Mortgage Loans on Real Estate

All other schedules for which provision is made in the applicable accounting regulations of the Commission have been included in the Consolidated Financial Statements of Falcon Financial Investment Trust or the notes thereto, are not required under the related instructions or are inapplicable, and therefore have been omitted.

(a)(3) The following exhibits are either provided with this Form 10-K or are incorporated herein by reference:

Exhibit Index

Exhibit No.	Description
3.1*	Amended and Restated Declaration of Trust.
3.2*	Bylaws of the Company.
4.1*	Form of Common Share Certificate.
10.1*	Revolving Warehouse Financing Agreement, dated January 7, 1998, among Falcon Financial, LLC, SunAmerica Life Insurance Company, LaSalle National Bank and ABN AMRO Bank N.V.
10.2*	First Amendment to Revolving Warehouse Financing Agreement and Waiver, dated March 25, 1998, among Falcon Financial, LLC, SunAmerica Life Insurance Company, LaSalle National Bank and ABN AMRO Bank N.V.
10.3*	Second Amendment to Revolving Warehouse Financing Agreement, dated October 2, 1998, among Falcon Financial, LLC, SunAmerica Life Insurance Company, LaSalle National Bank and ABN AMRO Bank N.V.
10.4*	Third Amendment to Revolving Warehouse Financing Agreement, dated April 19, 1999, among Falcon Financial, LLC, SunAmerica Life Insurance Company, LaSalle National Bank and ABN AMRO Bank N.V.
10.5*	Fourth Amendment to Revolving Warehouse Financing Agreement, dated October 29, 2001, among Falcon Financial, LLC, SunAmerica Life Insurance Company, LaSalle National Bank and ABN AMRO Bank N.V.
10.6*	Fifth Amendment to Revolving Warehouse Financing Agreement, dated November 21, 2003, among Falcon Financial, LLC, SunAmerica Life Insurance Company, Bank of New York (as successor to LaSalle National Bank) and ABN AMRO Bank N.V.
10.7*	Amended and Restated Senior Subordinated Loan Agreement, dated January 7, 1998 among Falcon Financial, LLC, SunAmerica Life Insurance Company and Goldman Sachs Mortgage Company.
10.8*	First Amendment to Amended and Restated Senior Subordinated Loan Agreement, dated June 8, 1998 among Falcon Financial, LLC, SunAmerica Life Insurance Company and Goldman Sachs Mortgage Company.
10.9*	Second Amendment to Amended and Restated Senior Subordinated Loan Agreement, dated October 2, 1998 among Falcon Financial, LLC, SunAmerica Life Insurance Company and Goldman Sachs Mortgage Company.
10.10*	Third Amendment to Amended and Restated Senior Subordinated Loan Agreement, dated April 19, 1999 among Falcon Financial, LLC, SunAmerica Life Insurance Company and Goldman Sachs Mortgage Company.

10.11*	Fourth Amendment to Amended and Restated Senior Subordinated Loan Agreement, dated October 29, 2001, among Falcon Financial, LLC, SunAmerica Life Insurance Company and

	Goldman Sachs Mortgage Company.
10.12*	Fifth Amendment to Amended and Restated Senior Subordinated Loan Agreement, dated July 29, 2002, among Falcon Financial, LLC, SunAmerica Life Insurance Company and Goldman Sachs Mortgage Company.
10.13*	Junior Subordinated Loan Agreement, dated April 19, 1999, between Falcon Financial, LLC and Falcon Auto Venture, LLC.
10.14*	2003 Equity Incentive Plan.
10.15*	Employment Agreement dated November 14, 2003 between Falcon Financial Investment Trust and Vernon B. Schwartz.
10.16*	Employment Agreement dated November 14, 2003 between Falcon Financial Investment Trust and David A. Karp.
10.17*	Employment Agreement dated November 14, 2003 between Falcon Financial Investment Trust and Joseph L. Kirk, Jr.
10.18	Sixth Amendment to Revolving Warehouse Financing Agreement, dated March 22, 2004, among Falcon Financial Investment Trust (as successor to Falcon Financial, LLC), SunAmerica Life Insurance Company, Bank of New York (as successor to LaSalle National Bank) and ABN AMRO Bank N.V. (incorporated by reference to the registrant's Current Report on Form 8-K, filed with the SEC on March 25, 2004).
21.1*	List of Subsidiaries.
23.1	Consent of KPMG LLP.
31.1	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
31.2	Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
32.1	Written Statement of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).

* Incorporated by reference to the registrant's registration statement on Form S-11, File No. 333-108603

(b) Reports on Form 8-K.

(c) Exhibits.

Falcon Financial Investment Trust hereby files as part of this Form 10-K the Exhibits listed in the Index to Exhibits.

(d) Consolidated Financial Statement Schedules.

The following consolidated financial statement schedules are filed herewith:

Schedule IV Mortgage Loans on Real Estate

Schedules not listed above have been omitted because they are inapplicable or the information required to be set forth therein is provided in the Consolidated Financial Statements of Falcon Financial Investment Trust or notes thereto.

72

SIGNATURES

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

FALCON FINANCIAL INVESTMENT TRUST

By: /s/ VERNON B. SCHWARTZ

Vernon B. Schwartz
Chief Executive Officer and Chairman
Date: March 30, 2004

By: /s/ DAVID A. KARP

David A. Karp
President and Chief Financial Officer
Date: March 30, 2004

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons in the capacities and on the dates indicated:

Signature	Title	Date
/s/ VERNON B. SCHWARTZ Vernon B. Schwartz	Chief Executive Officer And Chairman (Principal Executive Officer)	March 30, 2004
/s/ DAVID A. KARP David A. Karp	President, Chief Financial Officer and Trustee (Principal Financial Officer)	March 30, 2004
/s/ JOHN E. WARCH John E. Warch	Senior Vice President And Controller (Principal Accounting Officer)	March 30, 2004
/s/ THOMAS F. GILMAN Thomas F. Gilman	Trustee	March 30, 2004
/s/ JAMES K. HUNT James K. Hunt	Trustee	March 30, 2004
/s/ MARYANN N. KELLER Maryann N. Keller	Trustee	March 30, 2004
/s/ GEORGE G. LOWRANCE George G. Lowrance	Trustee	March 30, 2004

Independent Auditors' Report

The Board of Trustees
Falcon Financial Investment Trust:

Under date of March 26, 2004, we reported on the consolidated statements of financial position of Falcon Financial Investment Trust (the "Successor") as of December 31, 2003, and of Falcon Financial, LLC (the "Predecessor") as of September 30, 2003 and 2002, and the related consolidated statements of operations, changes in stockholders'/members' equity (deficit) and comprehensive income (loss) and cash flows for the periods from December 22, 2003 to December 31, 2003 (Successor period), and from October 1, 2003 to December 21, 2003, and for each of the years in the three-year period ended September 30, 2003 (Predecessor periods), which are included in the Successor's 2003 Form 10-K. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related consolidated financial statement

schedule included in the Successor's 2003 Form 10-K. This financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

In our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ KPMG LLP

New York, New York
March 26, 2004

S-1

FALCON FINANCIAL INVESTMENT TRUST
SCHEDULE IV MORTGAGE LOANS ON REAL ESTATE
December 31, 2003

Description (1)	# of Loans	Interest Rate	Final Maturity Year/Date	Periodic Payment Terms	Prior Mortgage Liens	Face Amount of Notes	Carrying Amount of Notes	Principal Amount of loans subject to delinquent principal or interest
Auto Dealership, FL	1	8.84%	April-2018	Interest and principal monthly		$ 18,500,000	$ 18,099,405	
Auto Dealership, VA	1	9.47%	October-2018	Interest and principal monthly		14,100,000	14,029,648	
Auto Dealership, SC	1	8.86%	April-2018	Interest and principal monthly		10,500,000	10,273,042	
Auto Dealership, FL	1	9.23%	October-2018	Interest and principal monthly		10,000,000	9,948,977	
Auto Dealership, NJ	1	8.14%	July-2018	Interest and principal monthly		10,000,000	9,858,610	
Auto Dealership, KS	1	9.52%	December-2018	Interest and principal monthly		9,550,000	9,550,000	
Auto Dealership, TN	1	8.87%	April-2023	Interest and principal monthly		9,000,000	8,890,329	
Auto Dealerships, NY (2)	2	9.12%	April-2018	Interest and principal monthly		9,000,000	8,809,954	
Auto Dealership, OH	1	8.40%	July-2018	Interest and principal monthly		7,300,000	7,199,214	
Auto Dealership, MD	1	9.22%	October-2018	Interest and principal monthly		7,150,000	7,113,485	
Auto Dealership, CA	1	9.24%	February-2011	Interest and principal monthly, Balloon payment $4,005,000		6,500,000	6,315,913	
Auto Dealership, NY/PA	1	9.32%	May-2018	Interest and principal monthly		5,700,000	5,597,709	
Auto Dealerships, various	3	various	various	Interest and principal monthly		9,050,000	8,882,294	
Auto Dealership, GA	1	9.49%	December-2013	Interest and principal monthly, Balloon payment $1,470,000		3,277,500	3,277,500	
	17					$ 129,627,500	$ 127,846,080	

(1) All loans represent first mortgages.

(2) Represents two loans that are cross-defaulted and cross-guaranteed.

FALCON FINANCIAL INVESTMENT TRUST
SCHEDULE IV MORTGAGE LOANS ON REAL ESTATE
December 31, 2003

Balance at October 1, 2000	$
Additional during fiscal 2001:	
New mortgage loans	150,330,067
Deductions during fiscal 2001:	
Collections of principal	1,469,653
Balance at September 30, 2001	148,860,414
Additions during fiscal 2002:	
New mortgage loans	100,113,000
Deductions during fiscal 2002:	
Collections of principal	2,571,689
Cost of mortgages sold	140,427,407
Balance at September 30, 2002	105,974,318
Additions during fiscal 2003:	
New mortgage loans	147,096,750
Deductions during fiscal 2003:	
Collections of principal	6,149,256
Cost of mortgages sold	141,060,558
Balance at September 30, 2003	105,861,254
Additions during the three months ended December 31, 2003:	
New mortgage loans	22,827,500
Deductions during the three months ended December 31, 2003:	
Collections of principal	842,674
Balance at December 31, 2003	$ 127,846,080