

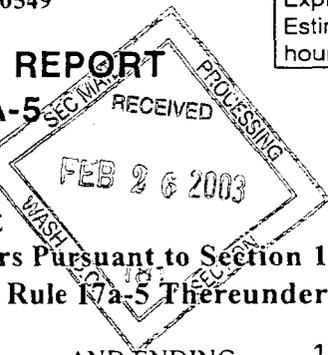


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**ANNUAL AUDITED REPORT
FORM X-17A-5
PART III**



SEC FILE NUMBER
8-49400

FACING PAGE

**Information Required of Brokers and Dealers Pursuant to Section 17 of the
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder**

REPORT FOR THE PERIOD BEGINNING 01/01/02 AND ENDING 12/31/02
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: CAPSTONE INVESTMENTS, INC.

OFFICIAL USE ONLY
FIRM I.D. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

4660 La Jolla Village Drive, Suite 1040

(No. and Street)

San Diego

CA

92122

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Steven P. Capozza

858-875-4500

(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Steven Martinez, CPA

(Name - if individual, state last, first, middle name)

5755 Oberlin Drive, Suite 310, San Diego, California

92121-4717

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

- Certified Public Accountant
- Public Accountant
- Accountant not resident in United States or any of its possessions.

PROCESSED

MAR 11 2003

**THOMSON
FINANCIAL**

FOR OFFICIAL USE ONLY

*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

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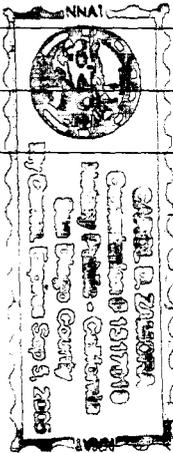
SEC 1410 (06-02)

OATH OR AFFIRMATION

I, Steven P. Capozza, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of CAPSTONE INVESTMENTS, INC., as of December 31, 2002, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer, except as follows:

~~Subscribed and sworn to before me this
25th day of February, 19 2003~~

NOTARY PUBLIC
in and for the County of _____ of California



[Signature]
Signature

President
Title

Subscribed and sworn to before me this
25th day of February, 19 2003
Carol J. Zamora

NOTARY PUBLIC
in and for the County of San Diego, State of California

- This report ** contains (check all applicable boxes):
- (a) Facing Page.
 - (b) Statement of Financial Condition. (BALANCE SHEET)
 - (c) Statement of Income (Loss).
 - (d) Statement of Changes in Financial Condition.
 - (e) Statement of Changes in Stockholders' Equity or Partners' or Sole Proprietors' Capital.
 - (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
 - (g) Computation of Net Capital.
 - (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
 - (i) Information Relating to the Possession or Control Requirements Under Rule 15c3-3.
 - (j) A Reconciliation, including appropriate explanation of the Computation of Net Capital Under Rule 15c3-3 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
 - (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
 - (l) An Oath or Affirmation.
 - (m) A copy of the SIPC Supplemental Report.
 - (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

**For conditions of confidential treatment of certain portions of this filing, see section 240.17a-5(e)(3).

Financial Statements

Capstone Investments, Inc.

*for the Year ended December 31, 2002
with Report of Independent Auditor*

Capstone Investments, Inc.

Financial Statement

Year ended December 31, 2002

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Steven Martinez, CPA

An Accountancy Corporation

◆ Suite 310
5755 Oberlin Drive
San Diego, California 92121-4717

◆ Phone: (858) 535-9935
Fax: (858) 535-9194

Report of Independent Auditor

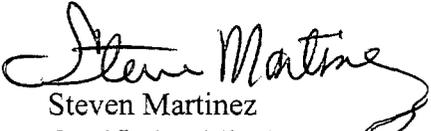
Board of Directors
Capstone Investments, Inc.:

I have audited the accompanying balance sheet of Capstone Investments, Inc. as of December 31, 2002, and the related statements of income, cash flows, and changes in shareholders' equity for the year then ended. These financial statements are the responsibility of the Company's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that I 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. I believe that my audit provides a reasonable basis for my opinion.

In my opinion the financial statements referred to above present fairly, in all material respects, the financial position of the Capstone Investments, Inc. at December 31, 2002 and the results of its operations and cash flows for the year then ended in conformity with generally accepted accounting principles.

My examination was made for the purpose of forming an opinion of the basic financial statements taken as a whole. The information contained on Schedules I, II, and III are presented for purposes of additional analysis and is not required as part of the basic financial statements, but as supplementary information required by Rule 17a-5 of the Securities and Exchange Act of 1934. Such information has been subject to the auditing procedures applied in the examination of the basic financial statements and, in my opinion, is fairly stated in all material respects in relating to the basic financial statements taken as a whole and in conformity with the rules of the Securities and Exchange Commission.


Steven Martinez
Certified Public Accountant

San Diego, California
February 22, 2003

Capstone Investments, Inc.
Balance Sheet
December 31, 2002

Assets

Current Assets:

Cash and cash equivalents	\$ 228,658
Commissions receivable	144,403
Clearing firm deposit	178,837
Prepaid taxes	4,500
Prepaid expenses	15,321
Total current assets	<u>571,719</u>

Fixed assets, net of \$159,856 accumulated depreciation	48,089
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Notes receivable	18,824
Other assets	12,729
Total assets	<u><u>\$ 651,361</u></u>

Liabilities and Stockholders' Equity

Liabilities

Accounts payable	\$ 13,629
Commissions payable	48,263
Soft dollars payable	225,332
Other current liabilities	10,307
Total liabilities	<u>297,531</u>

Commitments and Contingencies

Shareholders' equity

Common stock, no par value, 100,000 shares authorized, 75,000 shares issued and outstanding	19,567
Additional paid in capital	182,603
Retained earnings	216,660
Treasury stock, at cost; 2,500 shares	(65,000)
Total shareholders' equity	<u>353,830</u>

Total liabilities and stockholders' equity	<u><u>\$ 651,361</u></u>
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See accompanying notes.

Capstone Investments, Inc.
Statement of Income
For the year ended December 31, 2002

Income

Commissions	\$ 5,590,706
Signature guarantee	219,542
Other income	56,262
Total income	<u>5,866,510</u>

Expenses

Clearing charges	59,524
Commissions	1,332,305
Communications	72,830
Depreciation	83,538
Legal and professional	68,622
Rent	204,697
Salaries and wages	1,388,491
Soft dollar expenses	2,097,108
Travel and entertainment	169,634
General and administrative	514,010
Total operating expenses	<u>5,990,759</u>

Net loss from operations (124,249)

Other income (losses)

Loss on investments write off	(98,566)
Interest income	5,765
Net other income (losses)	<u>(92,801)</u>

State income taxes 800

Net loss \$ (216,250)

See accompanying notes.

Capstone Investments, Inc.
Statement of Cash Flows
for the Year ended December 31, 2002

Operating Activities:

Net loss \$ (216,250)

Adjustments to reconcile net income to net cash provided by operating activities:

Depreciation	83,538
Decrease in commissions receivable	381,168
Decrease in clearing house deposit	(21,052)
Increase in prepaid expenses	(8,712)
Increase in prepaid taxes	(4,500)
Decrease in accounts payable	(43,079)
Increase in soft dollars payable	101,537
Decrease in commissions payable	(144,508)
Decrease in pension plan payable	(56,031)
Decrease in other accrued liabilities	(23,239)
Total Adjustments	265,122

Net cash provided by operating activities 48,872

Investing Activities:

Furniture, fixtures and equipment	(22,668)
Investment write off	145,404
Increase in notes receivable	(14,117)
Net cash provided by investing activities	108,619

Financing Activities:

Capital contribution	50,000
Net provided by financing activities	50,000

Net increase in cash 207,491

Cash and cash equivalents at beginning of year	21,167
Cash and cash equivalents at end of year	\$ 228,658

Supplemental Disclosure:

Cash paid during the year for:

Income taxes	\$ 800
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See accompanying notes.

Capstone Investments, Inc.
Statement of Changes in Stockholders' Equity
For the year ended December 31, 2002

	Common Stock Shares	Amount	Additional Paid-In Capital	Retained Earnings	Treasury Stock Shares	Amount	Total Stockholders' Equity
Balance at December 31, 2001	7,500	\$ 19,567	\$ 132,603	\$ 432,910	2,500	\$ (65,000)	\$ 520,080
Capital contributed by shareholder	-	-	50,000	-	-	-	50,000
Net comprehensive loss	-	-	-	(216,250)	-	-	(216,250)
Balance at December 31, 2002	7,500	\$ 19,567	\$ 182,603	\$ 216,660	2,500	\$ (65,000)	\$ 353,830

See accompanying notes.

Capstone Investments, Inc.
Notes to Financial Statement
December 31, 2002

1. Organization and Summary of Significant Accounting Policies

Organization

Capstone Investments, Inc. (the "Company") was formed in California on September 25, 1995. The Company is closely held and is located at 4660 La Jolla Village Drive, Suite 1040, San Diego, California.

The Company conducts businesses as an introducing broker/dealer and provides brokerage and corporate finance services to retail and institutional clients. The Company's transactions are conducted on a fully disclosed basis with Wedbush Morgan Securities, a NYSE member firm. The Company is approved as a securities broker dealer by the Securities and Exchange Commission, National Association of Securities Dealers, and the State of California. Accordingly, the Company operates under the exemptive provisions of Securities and Exchange Commission ("SEC") Rule 15c3-3(k)(2)(ii).

Basis of Accounting

The accompanying financial statements are prepared on the accrual method of accounting, in accordance with generally accepted accounting principles, whereby revenues are recognized when earned and expenses are recognized when incurred.

Comprehensive income:

The Company adopted SFAS 130, "Reporting Comprehensive Income", which requires that an enterprise report, by major components and as a single total, the changes in equity. There were no other comprehensive income items for the year ended December 31, 2002.

Revenue recognition:

Securities transactions are recorded on a settlement date basis with related commission income and expenses also recorded on a settlement date basis.

Property, equipment and premises:

Fixed assets costing more than \$1,000 are capitalized and depreciated over an estimated useful life of five or seven years.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that effect certain reported amounts of assets, liabilities, revenues, expenses, and disclosures at the date of the financial statements. Actual results could differ from those estimates. Any adjustments applied to estimated amounts are recognized in the year in which the adjustments are determined.

Capstone Investments, Inc.
Notes to Financial Statement (Continued)
December 31, 2002

1. Organization and Summary of Significant Accounting Policies (Continued)

Cash and Cash Equivalents

Pursuant to FASB Statement of Accounting Standards No. 95, regarding the Statement of Cash Flows, certificates of deposits and securities with original maturities of three months or less are classified as cash equivalents. Certificates of deposit and securities with original maturities greater than three months are considered short-term investments. The Company does not hold any securities or certificate of deposits.

Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentration of credit risk consist of temporary cash investments. The Company places its temporary cash with financial institutions that are insured by the FDIC or SPIC. At December 31, 2002 the Company had \$388,538 on deposit with that exceeded the maximum insurance coverage.

Income Taxes

The Company is a taxed under the provisions of Subchapter S of the Internal Revenue Code. Accordingly, the Company is not subject to Federal income tax. No provision for Federal income taxes is included in these financial statements.

The Company is subject to a California Franchise Tax at a flat rate of 1.5% of its profit, but not less than \$800.

2. Clearing Firm Deposit

At December 31, 2002, a balance of \$178,837 is on deposit with the Company's clearing firm. \$169,538 of this amount is on deposit to specifically satisfy the Company's deposit requirement under the clearing agreement.

3. Fixed Assets

At December 31, 2002, fixed assets consisted of the following:

Furniture, fixtures and equipment	\$197,397
Leasehold improvements	<u>10,548</u>
Total fixed assets	\$207,945
Less: Accumulated depreciation	<u>(159,857)</u>
Fixed assets, net	<u>\$ 48,088</u>

Capstone Investments, Inc.
Notes to Financial Statement (Continued)
December 31, 2002

4. Lease Obligations

The Company leases two offices under operating leases. The commencement and termination of each lease are different. Under the conditions of the lease agreements, the Company is obligated for future minimum lease obligations as follows:

Year ending December 31, 2003	\$ 216,142
Year ending December 31, 2004	\$ 222,393
Year ending December 31, 2005	\$ 221,985
Year ending December 31, 2006	\$ 213,463
Year ending December 31, 2007	\$ 221,905
Thereafter	<u>\$ 56,004</u>
Total	<u>\$1,151,892</u>

5. Net Capital Requirements

The Company is subject to the uniform net capital rule (Rule 15c3-1) of the Securities and Exchange Commission, which requires both the maintenance of minimum net capital and the maintenance of a maximum ratio to aggregate indebtedness to net capital.

Net capital and aggregate indebtedness change day by day, but by December 31, 2002, the Company's net capital of \$254,367 exceeded the minimum net capital requirement by \$204,367. The Company's ratio of aggregate indebtedness to net capital was 1.17 to 1. This ratio is less than the 15 to 1 ratio requirement for a broker dealer in business for more than one year.

Capstone Investments, Inc.
Schedule I - Computation of Net Capital Requirements Pursuant to Rule 15c3-1
December 31, 2002

Computation of Net Capital	Focus Report December 31, 2002	Audited Financial Statements December 31, 2002	Change
Total assets	\$ 748,003	\$ 651,361	\$ 96,642
Less: Liabilities	(320,050)	(297,531)	(22,519)
Net worth	<u>427,953</u>	<u>353,830</u>	<u>74,123</u>
Less: Non-Allowable Assets			
Prepaid taxes	-	(4,500)	(4,500)
Fixed assets	(97,745)	(48,089)	49,656
Notes receivable	(18,825)	(18,824)	(1)
Prepaid expenses	(15,321)	(15,321)	-
Other assets	(12,729)	(12,729)	-
Total Non-Allowable Assets	<u>(144,620)</u>	<u>(99,463)</u>	<u>49,655</u>
Tentative Net Capital	283,333	254,367	123,778
Less:			
Haircuts	(61,125)	-	(61,125)
Net Capital	<u>222,208</u>	<u>254,367</u>	<u>\$ 62,653</u>
Minimum Net Capital Required	21,337	50,000	
Excess Net Capital	<u>\$ 200,871</u>	<u>\$ 204,367</u>	
Ratio of aggregate indebtedness to net capital	<u>1.44%</u>	<u>1.17%</u>	

The changes between the Company's Focus Report and the Audited Financial Statements are attributed to year end accruals, depreciation calculation, write off of investments, and management's adjustment for estimates.

See accompanying notes.

Capstone Investments, Inc.

Determination of Reserve Requirements
Under Rule 15c3-3 of the Securities and Exchange Commission
December 31, 2002

Capstone Investments, Inc. is exempt from the Reserve Requirement of Rule 15c3-3.

Capstone Investments, Inc.

Information Relating to Possession of Control Requirements Under Rule 15c3-3
December 31, 2002

Capstone Investments, Inc. is exempt from the Possession and Control Requirements of Rule 15c3-3.

Steven Martinez, CPA

An Accountancy Corporation

◆ Suite 310
5755 Oberlin Drive
San Diego, California 92121-4717

◆ Phone: (858) 535-9935
Fax: (858) 535-9194

SUPPLEMENTAL ACCOUNTANT'S REPORT INTERNAL CONTROLS

Board of Directors
Capstone Investments, Inc.

In planning and performing my audit of the financial statements of Capstone Investments, Inc. for the year ended December 31, 2002, I considered its internal control structure, for the purpose for safeguarding securities, in order to determine our auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control structure.

Also, as required by rule 17a-5(g)(1) of the Securities and Exchange Commission, I have made a study of the practices and procedures (including tests of compliance with such practices and procedures) followed by Capstone Investments, Inc. that I considered relevant to objectives stated in rule 17a-5(g), (1) in making the periodic computations of aggregate indebtedness (or aggregate debits) and net capital under rule 17a-3(a)(11) and the reserve required by rule 15c3-3(e). I did not review the practices and procedures followed by the Company (i) in making the quarterly securities examinations, counts, verifications and comparisons, and the recordation of differences required by Rule 17a-13, or (ii) in complying with the requirements for prompt payment for securities of Section 8 of Regulation T of the Board of Governors of the Federal Reserve System, because the Company does not carry security accounts for customers or perform custodial functions relating to customer securities.

The management of the Company is responsible for establishing and maintaining internal control structure and the practice and procedures referred to in the preceding paragraph in fulfilling this responsibility, estimates and judgements by management are required to assess the expected benefits and related costs of internal control structure policies and procedures and of the practices and procedures referred to in the preceding paragraph and to assess whether those practices and procedures can be expected to achieve the Commission's above mentioned objectives. Two of the objectives of an internal control structure and the practices and procedures are to provide management with reasonable, but not absolute, assurance that assets for which the Company has responsibility are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and recorded properly to permit preparation of financial statements in conformity with generally accepted accounting principles. Rule 17-5(g) lists additional objectives of the practices and procedures listed in the preceding paragraph.

Because of the inherent limitations in any internal control structure or the practices and procedures referred to above, errors or irregularities may occur and not be detected. Also, projection of any evaluation of them to future periods is subject to the risk they may become inadequate because of changes in conditions or that the effectiveness of their design and operation may deteriorate.

My consideration of the internal control structure would not necessarily disclose all matters in the internal control that might be material weakness under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which design or operation of the specific internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. However, I noted no matters involving the internal control structure, including procedures for safeguarding securities, that I considered to be material weakness as defined above.

I understand that practices and procedures that accomplish the objectives referred to in the second paragraph of this report are considered by the Commission to be adequate for its purpose in accordance with the Securities Exchange Act of 1934 and related regulations, and that practices and procedures that do not accomplish such objectives in all material respects indicate material inadequacy for such purposes. Based on this understanding and on my study, I believe that the Company's practices and procedures were adequate at December 31, 2002 to meet the Commission's objectives.

This report is intended solely for the use of management, the Securities and Exchange Commission, and other regulatory agencies, which rely on Rule 17-a-5(g) under the Securities Exchange Act of 1934 and should not be used for any other purpose.


Steven Martinez
Certified Public Accountant

San Diego, California
February 20, 2003