Annual Report

Sanders Morris Harris Group

Maintaining the Course

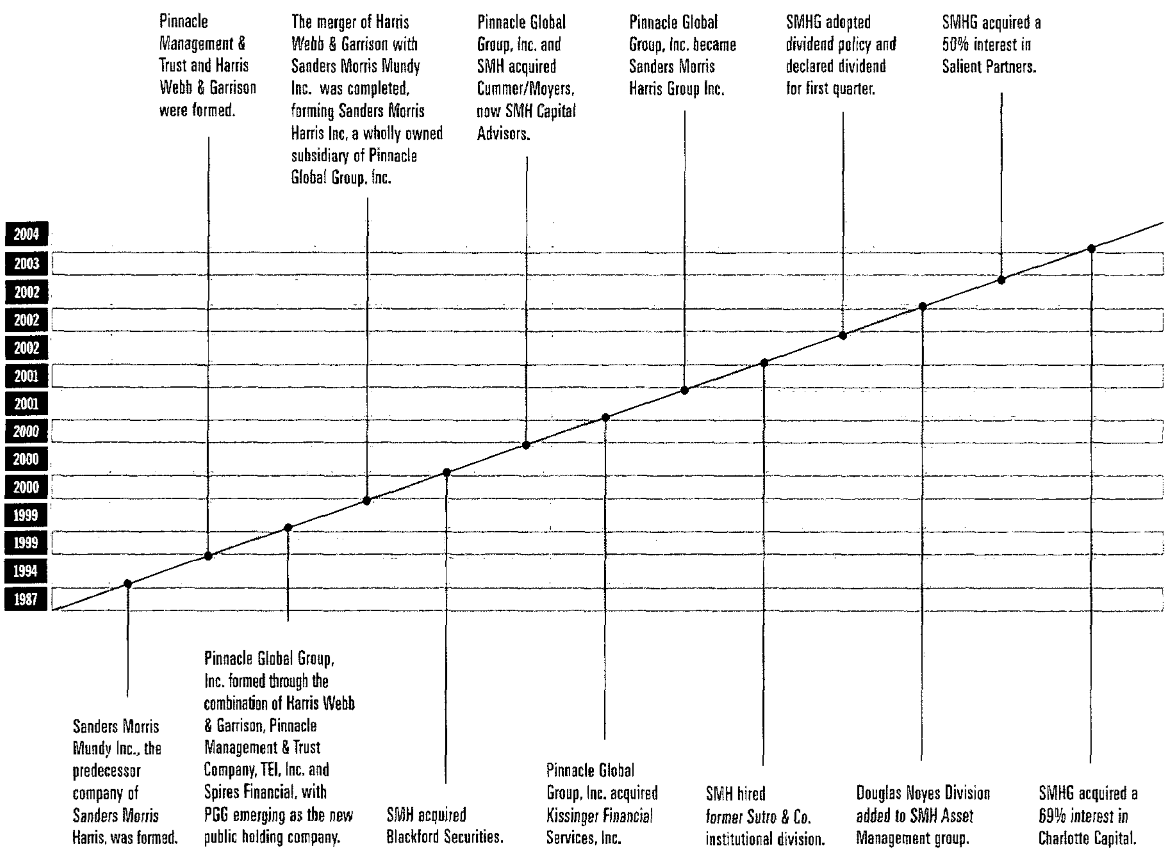
PE
12-31-03

ARS

Corporate Profile

SANDERS MORRIS HARRIS GROUP INC. is a financial services holding company headquartered in Houston, Texas. Its primary businesses are asset and wealth management, investment banking/private equity and institutional brokerage. It operates through subsidiaries, most of which are housed in its broker-dealer subsidiary, Sanders Morris Harris Inc. Its major non-brokerage activities include SMH Capital Advisors, a registered investment advisor specializing in fixed-income securities; Charlotte Capital, an investment management firm concentrating on small- and mid-cap companies; Kissinger Financial Services, a registered investment advisory firm providing comprehensive financial planning; and Douglas Noyes, a mid/large capitalization manager. Additionally, Sanders Morris Harris Group owns 50 percent of Salient Partners, a wealth manager, which also includes Pinnacle Trust Co., LTA, a Texas-chartered fiduciary.

Corporate Timeline



Maintaining the Course

Our comparatively steady record of growth is a direct result of the Company's unwavering focus on doing what we do best and avoiding what we don't know.

Dear Shareholder:

SANDERS MORRIS HARRIS GROUP had a fine year in 2003. Net income was $10.4 million, or $0.59 per diluted share, compared to $0.32 in the prior year. Revenue was $103.9 million, an increase of 26% over 2002. Each of the Company's major operating groups performed well, with particular growth in the asset management and investment banking divisions. In addition, our merchant banking activities, consisting of the Company's investment portfolio and interests in limited partnerships, produced net gains of $5.3 million before taxes in 2003 compared to $1.0 million during 2002.

The Company's fourth quarter earnings per diluted share were $0.20, an increase of 43% over the same period in 2002. Revenues were $31.2 million versus $24.9 million for the same three-month period in 2002.

Sanders Morris Harris Group ended 2003 with assets in excess of $137 million, including cash and equivalents of $32.6 million, and no funded debt. Our financial position is extremely strong.

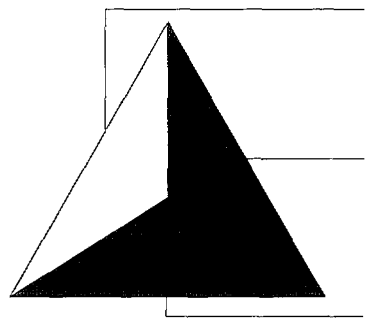
A CHARTED COURSE

In last year's annual report to shareholders, we discussed the course Sanders Morris Harris Group has charted to generate higher levels of earnings, a course designed to mitigate the impact of market cycles. Our plans coalesced nicely during the past 12 months, with each major business unit contributing significantly to 2003's net income.

The upswing in the stock market unquestionably fueled some of those gains, although the improvement in our results went beyond those of the equity markets. The financial highlights included in this report, coupled with the illustrations of our various investment funds' results on page 5, provide detailed insight into our performance during the year.

One Business, Triangulated Approach

A tripod is the strongest, most stable form of support. Following the tripod model, Sanders Morris Harris Group has a three-pronged business.



Business Tripod

Sanders Morris Harris Group's business model is based on a three-pronged approach:

- asset and wealth management,
- investment banking/private equity, and
- institutional brokerage.

ASSET AND WEALTH MANAGEMENT
Wealth management is one of our growth focuses. Balanced combinations of specialized equity management, hedge funds, private equity, high-yield and high-grade bonds and quantitative investment programs can help investors to achieve superior returns. We have strengthened our already considerable capabilities in these areas through acquisitions and hiring.

As reported, the Company's emphasis is on committing its capital focuses importantly, though not exclusively, on asset management, wealth management and prime brokerage services. That emphasis continued in 2003. The dollars we invested over the years in the development of these businesses have rewarded Sanders Morris Harris handsomely.

Underlying our service to high net worth investors is our unrelenting desire to first keep their wealth intact. Our senior investment professionals, top-rated analysts and wealth management teams work to ensure full access to an extensive menu of investment programs that aid in that commitment.

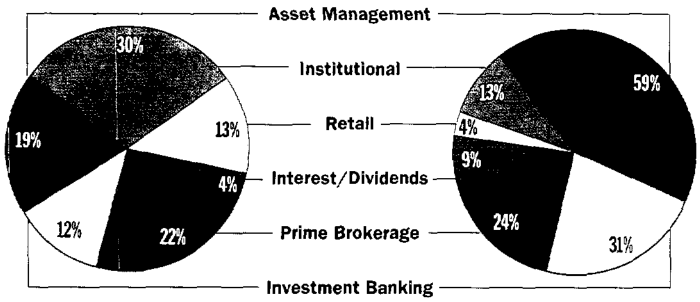
➢ The ongoing growth of prime brokerage services clearly reflects the opportunity in providing highly personal, high-technology support to selected hedge funds. It is a sector of high importance to our Company. We seek out well-managed hedge funds looking for more specialized service than others are able to provide.

➢ Our retail brokerage business returned to profitability and gained momentum in the fourth quarter as the markets improved and individual investors regained confidence. Average broker production enjoyed a six-figure advance and several top-caliber financial advisors joined the firm. SMH Partners, our independent representative network, experienced similar momentum, topping $1 billion in assets advised, and represents an important part of our asset management plan.

➢ In early 2004, we formed Concept Capital as a breeder funding source for some of the best new hedge fund managers and seeded it with an initial $5 million. Concept Capital gives investors an opportunity to participate in the fortunes — good or bad — of these carefully screened professionals.

INVESTMENT BANKING/ PRIVATE EQUITY
Investment banking and private equity can be both highly profitable and highly cyclical. Following a difficult 2002, a year marked by industry-wide declines in investment banking revenues and staffing,

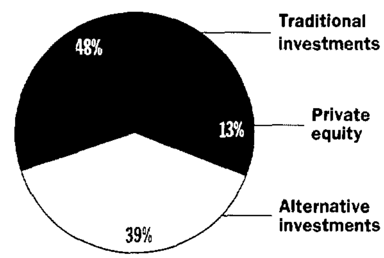
Revenues & Pre-tax Profits Assets Under Management



Revenues

*Pre-tax Profits**

**Due to unallocated overhead total profits do not add to 100%.*



Assets Under Management

underwritings picked up in late-2003. Despite the lean new issuance calendar through the first three quarters, Sanders Morris Harris served as manager or co-manager of eight offerings last year. They included a highly successful lead-managed $40 million offering for NYSE-listed GulfTerra Energy Partners. We also enjoyed noteworthy success in Private Investments in Public Equities (PIPEs), utilizing our expertise in small-cap company investments. These offerings allowed Sanders Morris Harris to present interesting opportunities to affluent private clients and institutions worldwide. As a quality check, we continued our practice of "investment in common" wherever regulatory and ethical considerations permitted it.

We are particularly well known in the energy, technology, media, healthcare and environmental sectors. These were areas of relative favor in 2003 and thus far in 2004. The investment banking business has displayed significant activity again in the early months of 2004, with a rejuvenated IPO market and higher stock prices paving the way for a number of IPO, follow-on and PIPE mandates.

Our investment banking activity sometimes yields ownership positions — in stocks, warrants, partnership interests and the like — in the underlying companies. Accounting standards require that our merchant portfolio be marked to market each quarter, which can cause significant increases or decreases in our reported net income. Operating profits in 2003 were boosted by $5.3 million from gains in our merchant portfolio, which currently totals $37 million.

- Life Sciences Opportunities Fund II was launched in December 2003 with $107 million in committed capital. It will provide yet another proprietary opportunity for our clients to take advantage of the dynamics in the life sciences and healthcare industries. Please refer to the related story on page 6 for more details.

- Construction of the world's largest, third-of-its-kind, proton beam therapy center commenced in mid-2003. Working alongside The University of Texas M.D. Anderson Cancer Center and The Styles Company, we secured $125 million in financing for the center. Upon completion, the proton radiation facility in Houston, Texas, will offer an advanced form of radiation therapy for cancer treatment. The therapeutic properties of this technology have sparked an interest in the development of additional proton therapy centers. Sanders Morris Harris is actively pursuing several of these opportunities.

INSTITUTIONAL BROKERAGE

The institutional equity and fixed-income sectors are major cash generators for the Company. Both posted gratifying results in 2003. The addition of five sales persons, as well as several traders and analysts, strengthened our institutional equity capabilities. The institutional equity business is one of the firm's core strengths and an integral part of our private equity practice as well.

Based on the significant opportunities that we forsee, the institutional equity and fixed-income markets will be among the important drivers of the Company's future growth.

The Endowment Master Fund

Reflecting our commitment to helping our clients to invest well, Salient Partners and Pinnacle Trust teamed in early 2003 with Mark W. Yusko, until recently the Chief Investment Officer at the University of North Carolina, to develop The Endowment Master Fund.

This innovative investment vehicle reaches beyond the bounds of traditional cash, fixed-income and equity portfolios to seek absolute returns through broad, diversified investments — including enhanced fixed-income, real estate, private equity, long/short, international hedged equity and natural resources — and is designed to replicate the investment approach of large university endowments. At year-end 2003, The Endowment Master Fund managed approximately $100 million. By its first anniversary in April 2004, the Fund was approaching the $200 million level.

Further Steps Forward Along a Familiar Path

ACQUISITIONS

Companies, and particularly financial services firms, that stray beyond the experience of their senior managers put themselves in peril. With that in mind, Sanders Morris Harris Group has remained dedicated to our core businesses:

- asset and wealth management,
- investment banking/private equity, and
- institutional brokerage.

Sanders Morris Harris Group in 2003 continued down a path of careful expansion in these three interrelated realms. We weighed our abilities to assimilate people and entities, mindful that a company like ours must not overstep its ability to control its growth. With that as the backdrop, we are pleased to report the following strategic transactions.

SALIENT PARTNERS

Sanders Morris Harris Group in April 2003 acquired a 50% interest in Houston-based Salient Partners, L.P.

At year-end 2003, with Pinnacle Trust's operations integrated into those of Salient, assets under management totaled $1.3 billion. Salient itself manages approximately $670 million in assets for high net worth individuals and families, as well as nearly $200 million in The Endowment Master Fund.

The Endowment Master Fund commenced operations in April of 2003. Its investment performance generated a 22% gain for the year. Assets were $100 million at year end and are approaching $200 million. Please refer to the accompanying feature on this page for additional information on this rather unique investment.

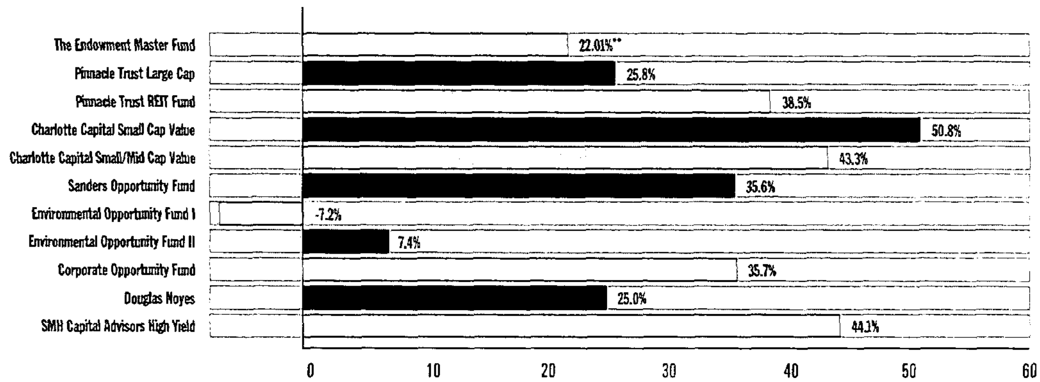
Salient Partners represents a prime example of a tailored, strategic acquisition for Sanders Morris Harris Group. The process that Salient employs for investing capital — broad diversification with a focus on asset classes that emphasize absolute returns — has been a tremendous benefit to the clients of both Sanders Morris Harris Group and Salient Partners. Participation in several of SMH's investment programs likewise benefits Salient's clients.

After a long bear market, thoughtful investors have become increasingly aware of absolute returns, an approach embraced by Salient.

CHARLOTTE CAPITAL

Sanders Morris Harris Group acquired a 69% interest in North Carolina-based Charlotte Capital, an investment management firm, in April 2004. Charlotte Capital is widely recognized for its expertise in value-based small-cap investment

*Performance Scorecard - 2003**



* The foregoing data is provided for informational purposes only and is not a solicitation or offer to purchase or sell any security. The performance data quoted represents past performance; past performance may not be indicative of and does not guarantee future results.
** Since inception on 4.1.03.

management and has $400 million in assets under management, predominantly institutional. With this alliance comes opportunities to introduce other SMH funds to the institutional market while also providing a new investment venue for our high net worth clients. In addition, Charlotte Capital invests in many of the same types and sizes of companies as Sanders Morris Harris Group. Hence we expect a good deal of intellectual crossover between the organizations.

PORTFOLIO STRATEGIES, INC.
We acquired a 20% minority interest in Seattle-based Portfolio Strategies, Inc. (PSI), with the option to acquire an additional 20%. This gives our SMH Partners division access to another superb set of money management programs.

Portfolio Strategies manages more than $800 million in assets, a significant portion of which is invested in variable annuity separate accounts. PSI is also recognized for its distribution of customized investment strategies to the independent broker-dealer community. This is an attractive outlet for our existing asset and wealth management vehicles, and we look forward to working with PSI in the coming months.

CREST ADVISORS
In early 2004, Sanders Morris Harris exercised its option to acquire New York-based Crest Advisors, an investment bank. Crest is managed by William Sprague, who was formerly co-head of mergers and acquisitions at Solomon Smith Barney.

Crest is particularly adept in technology, media, telecommunications and middle market advisory assignments. It concentrates on the mid-market and is an ideal fit with SMHG's existing banking operations. The addition of Crest Advisors should add significantly to the profits of the Company's investment bank.

TULSA OFFICE
Sanders Morris Harris Group entered the Oklahoma market in December 2003 with the purchase of the U.S. Bancorp Piper Jaffray branch in Tulsa. Our energy research, which aligns well with the energy emphasis in both Houston and Tulsa, made the latter an attractive market for us to enter.

This branch's leadership is well known to us. Its experienced staff transitioned rather seamlessly to Sanders Morris Harris Group. We expect to attract additional professionals to the Tulsa operation during the coming year.

New Life for Life Sciences

LOF Partners LLC, the life sciences arm of Sanders Morris Harris Group, raised an impressive $107 million for its new fund, Life Sciences Opportunities Fund II. More than 95% of the investors in its predecessor fund elected to participate in the new fund, reflecting their confidence in our life sciences management team. The Fund (now closed) invests in companies in the life sciences and healthcare industries.

A common thread in the SMH Private Equity Funds, including Life Sciences Opportunities Fund II, is their emphasis on securities often excluded from traditional mutual fund portfolios. Many of these are equity and equity-linked securities of late-stage private and small public companies led by dynamic management teams with long-term vision. These are precisely the types of investments that often offer the highest potential returns.

Corporate Culture

INTEGRATION PROCESS

The integration of new affiliates requires unified information technology, accounting systems and administration. It also means integrating new people into our corporate culture.

The most appropriate time to begin the assimilation process is at the very outset, even before the transaction has closed. By setting standards early, Sanders Morris Harris Group provides a clear expectation about what we want and how we operate. We expect everyone to share our culture of competence — doing well for clients, doing well for stockholders and investing alongside our clients when suitable.

Our careful integration process, coupled, we confess, with a helpful tailwind in the stock market this past year, has helped these newly acquired companies and new units to post strong results.

CORPORATE CONDUCT

We are careful to adhere systematically to all applicable rules and regulations. We also try to go beyond the letter of the law. We want to do what's right, albeit aware that "right" is sometimes difficult to define. We therefore consider this report a timely opportunity to articulate the ethical footings on which Sanders Morris Harris Group is grounded.

While our business is money related, Sanders Morris Harris Group is basically a galaxy of people. We are committed to doing what is right for all constituents. We want employees to (i) work as a team, (ii) avoid the temptation to cut corners and (iii) keep the interests of clients and stockholders paramount.

There's probably some healthy self interest in that, as our employees own nearly 40% of Sanders Morris Harris Group's common stock. We have spent many years building the reputation of this Company. We have kept salaries low to reflect our focus on per share earnings, not personal cash compensation.

We want Sanders Morris Harris Group's reputation to be stellar, and are pleased to forego activities that might sully that image. The tone of the Company reflects an emphasis on doing what's right, all the while knowing there can be no promise of perfection.

Outlook for 2004

We demonstrate our confidence by investing alongside clients wherever possible. We plan to further develop our core competencies and the lines of business we know well with the continuing goal of investing very successfully.

Looking Forward

OUTLOOK FOR 2004

The Company's management team is optimistic about the possibilities for SMHG, its clients and stockholders in the coming year. The underlying theme of this year's report — maintaining the course — is one that has existed since Sanders Morris Harris Group commenced operations; it is a theme that you will see again in 2004 and beyond as we continue to grow the Company.

Recognizing that it is individuals, not systems and computers, that attract new business to our organization, an important part of our growth strategy is adding talent that complements existing skills. We are actively pursuing opportunities to acquire firms in our three core areas, ones that strengthen Sanders Morris Harris Group's geographic footprint, deepen our investment base and allow the Company to realize cost benefits by leveraging our infrastructure.

Our focus has always been on doing what we do best and demonstrating our confidence by investing alongside clients. We plan to further develop our core competencies and the lines of business we know well with the continuing goal of investing very successfully.

CLOSING COMMENTS

We know that people — clients, employees, stockholders — not merely capital, are key to our business.

- We offer our sincere appreciation to the hundreds of dedicated employees who provide hard work, superior service, top performance and innovative thinking. They are the bedrock of everything Sanders Morris Harris Group does.
- Our Company is in business because of our clients, to whom we offer our appreciation for your loyalty. You have kept us on our toes... and rightfully so. The opportunity to invest alongside you keeps us mindful that our job is to provide you with superior results and service. We remain committed to keeping your interests at the forefront of our decisions.
- Shareholders, as the name implies, share ownership in the Company. We will continue along our charted course to endeavor to enhance the value of your investment. We welcome your comments, suggestions and questions, and look forward to reporting additional developments in 2004.

Respectfully,

Sanders Morris Harris Group

Board of Directors

LEFT TO RIGHT

JOHN H. STYLES   NOLAN RYAN   DONALD R. CAMPBELL   DAN S. WILFORD   W. BLAIR WALTRIP   RICHARD E. BEAN

BEN T. MORRIS   GEORGE L. BALL   DON A. SANDERS   ROBERT E. GARRISON II   TITUS H. HARRIS, JR.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(mark one)

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2003, OR**

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

Commission File No. 0-30066

Sanders Morris Harris Group Inc.

(Exact name of registrant as specified in its charter)

Texas	**76-0583569**
(state or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

600 Travis, Suite 3100
Houston, Texas 77002
(Address of principal executive office)
Registrant's telephone number, including area code: **(713) 993-4610**

Securities Registered Pursuant to Section 12(b) of the Act: None
Securities Registered Pursuant to Section 12(g) of the Act:
Common Stock, $.01 par value per share
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No___

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes X No __

The aggregate market value of the shares of common stock held by nonaffliates of the registrant at June 30, 2003 was $99.7 million. For purposes of this computation, all executive officers, directors and 5% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed an admission that such officers, directors and beneficial owners are, in fact, affiliates of the registrant.

As of March 4, 2004, the registrant had 17,377,416 outstanding shares of Common Stock, par value $0.01 per share.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant's Notice of Annual Meeting of Shareholders and definitive Proxy Statement pertaining to the 2003 Annual Meeting of Shareholders (the "Proxy Statement") and filed pursuant to Regulation 14A is incorporated herein by Reference into Part III of this report.

SANDERS MORRIS HARRIS GROUP INC. AND SUBSIDIARIES
INDEX

PART I.

PART II.

PART III.

PART IV.

PART I.

Item 1. *Business*

General

Sanders Morris Harris Group Inc., a Texas corporation formed in 1998 ("SMHG" or "the Company"), provides a broad range of financial services through its wholly owned operating subsidiaries. Our financial services include institutional, prime and retail brokerage, investment banking, merchant banking, financial advisory, trust related services, asset management and financial planning. We serve a diverse group of institutional, corporate and individual clients.

In May 2003, the Company acquired a 50% ownership interest in the Salient companies and a 23.15% profits interest in the advisor to The Endowment Fund, a related entity. Based in Houston, Texas, the Salient companies provide investment advisory services to individuals and institutions. The Endowment Fund is a diversified fund of funds using fund managers that specialize in a variety of investment approaches. In conjunction with the Salient acquisition, Pinnacle Management & Trust Co., our trust subsidiary, was contributed to Salient and was renamed Pinnacle Trust Co., LTA.

In December 2003, the Company acquired the Tulsa, Oklahoma branch office of U.S. Bankcorp Piper Jaffray Inc. The Tulsa office provides retail brokerage services to its clients.

The historical financial information contained in this document includes the results of operations and financial position of our current businesses from the dates of acquisition, except for our discontinued businesses.

Business Strategy

Our business strategy is to (1) increase our asset management business; (2) increase our capital markets activities; (3) improve the profitability of our brokerage operations; (4) enhance the range of financial services we offer our clients; and (5) supplement internal growth with strategic acquisitions. We believe certain cross-selling opportunities exist among the financial services firms, and certain unquantified potential operating efficiencies will also be available. The principal elements of our business strategy are:

- *Increase Asset Management Business.* We intend to grow through expansion of our asset management business, including prime brokerage and related services by improving the interface between our asset management operations and our various subsidiaries, and by increasing the assets under our management through acquisitions and internal growth.

- *Increase Capital Markets Activities.* We intend to increase our investment banking and merchant banking business by committing greater resources to companies, industries and geographic regions that management believes offer the greatest opportunities. We also believe that consolidation within the investment banking industry will offer greater opportunities for high caliber firms that maintain their local and industry-specific focus.

- *Improve Profitability of Brokerage Operations.* We intend to improve the profitability of our brokerage operations primarily by hiring additional experienced and productive financial advisors and by providing our financial advisors with specialized training as well as product offerings, information systems, support and access to the services of each of our financial services companies.

- *Enhance Personalized, High-End Service.* We seek to provide excellent investment advice suited to each client. To that end, our financial services subsidiaries have traditionally sought to attract and retain clients by offering a high level of personal service. We intend to increase that commitment by providing our clients with advanced account and investment information systems, flexibility in determining appropriate fee schedules for certain services based upon the level of client needs and by providing an array of investment and financial planning services.

- *Supplement Growth with Strategic Acquisitions.* We plan to actively pursue opportunities to acquire or combine with other firms with complementary businesses to strengthen or expand our geographic or product offering base. Our management believes that attractive acquisition opportunities exist, particularly among smaller, specialized regional financial firms that want to affiliate with a larger company while still retaining their identity and entrepreneurial culture. In addition, we believe that the consolidation trend in the financial services industry will allow us to hire proven financial professionals who prefer the culture and opportunities inherent in a creative regional firm. Management believes that acquisitions may also allow us to realize cost benefits by leveraging our infrastructure.

Services

We provide our financial services through our operating subsidiaries – Sanders Morris Harris Inc., Salient Capital Management, and SMH Capital Advisors. The financial services offered by each of these entities are described below.

Sanders Morris Harris Inc. , "SMH"

General. SMH provides a range of financial services including institutional, prime and retail brokerage, investment research, investment banking, merchant banking and market making. Additionally, SMH has organized and holds an interest in a number of proprietary funds that invest primarily in small to medium capitalization companies in a number of industries.

Private Client. Our strategic plan in the private client business is to attract and retain experienced financial advisors, especially those able to utilize our sophisticated investment programs. Our private client business is focused on high net worth individuals with whom we have developed and maintained relationships over time. As a full service broker, we offer our private clients brokerage services relating to corporate debt and equity securities, including the securities of companies followed by our research analysts, underwritings that we co-manage or in which we participate, private placements of securities in which we serve as placement agent, mutual funds, 401(k) plans, wrap-fee programs, money market funds and insurance products. Commissions are charged on agency transactions in exchange-listed securities and securities quoted on the Nasdaq National Market or in the over-the-counter market. In addition to retail commissions, we generate fee revenue from asset-based advisory services and managed accounts where the charges are based on a percentage of the assets held in the client's account in lieu of commissions on a transaction-by-transaction basis.

We provide our private clients with a broad range of services delivered in a personalized, service-oriented manner. In addition to recommending and effecting transactions in securities, we provide other services to our retail clients that include portfolio strategy, investment research service, financial planning, assistance in the sale of restricted securities and tax, trust and estate advice. Clients can access their personal portfolio on-line and use our extensive research library.

We employ Series 7-licensed retail brokers who average over 15 years experience in the securities brokerage business. Additional Series 7-licensed retail brokers are affiliated with the Company through our Sanders Morris Harris Partners division. We generally do not hire inexperienced brokers or trainees to work as retail brokers. We believe we can attract and retain experienced brokers by providing them with a high level of support, a corporate culture that encourages performance, employee stock ownership, advanced technologies, competitive compensation packages and the opportunity for them and their clients to participate in private placements and public offerings of securities we manage or underwrite.

Institutional Brokerage. Our institutional stock brokerage strategy is to provide equity research coverage and trading services focused on companies with a presence in the United States. Our clients are a broad array of institutions throughout North America, Europe and Asia. Areas of concentration include the construction industry, financial services, biotechnology and healthcare, oil and gas exploration and production, oilfield services, pipelines, entertainment and media, retailing and technology. We provide our institutional clients with research and execution trading services in both exchange-listed equity securities and equity securities quoted on Nasdaq. We also distribute to institutional clients equity securities from offerings that we co-manage or underwrite. Our institutional clients include banks, retirement funds, mutual funds, endowments, investment advisors and insurance companies. We perform institutional brokerage services from offices in Houston, New York, Los Angeles, San Francisco and Denver.

Investment Research. We use our proprietary equity research analysis to drive or assist a large portion of our business. This analysis is based on economic fundamentals, using tools such as price-to-earnings multiples, price-tobook value comparisons, both absolute and relative to historic norms, and our research department's own earnings forecasts. We intend to rely primarily on our own research rather than on research products purchased from outside research organizations. We believe that the services provided by our research department have a significant impact on our revenue-generating activities, including retail and institutional brokerage.

Prime Brokerage. The brokerage industry has developed a service known as prime brokerage in which a customer, usually a hedge fund, maintains a cash or margin account with a prime broker to record transactions executed at one or more executing brokers. We provide trade execution, clearing, bookkeeping, reporting, custodial, securities borrowing, financing, research and fund raising services for our prime brokerage customers. By providing these services to our customers, we allow them the opportunity to focus on managing assets and generating returns for their clients.

Fixed Income Brokerage. Through our fixed income division, we provide brokerage services to institutional clients relating primarily to fixed-income securities, such as municipal securities, U.S. government and agency securities, mortgage-related securities, including those issued through Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corp., and corporate investment-grade and high-yield bonds. Commissions are charged on all institutional securities transactions based on rates formulated by SMH.

Rather than trading a wide variety of securities in direct competition with Wall Street firms, we have developed a niche strategy to trade certain fixed-income securities, including U.S. government securities, certain mortgage related securities and collateralized mortgage obligations. In our trading activities, we generally deal with institutional clients. We buy and sell round-lot and odd-lot positions, and act as market-maker in those positions. Many of our counterparties in these transactions are other broker-dealers.

We are also active as a secondary market broker for residential, consumer and commercial loans, and derive revenue from the placement of mortgage loans and servicing.

Investment Banking and Underwriting Activities. Our investment banking strategy is to build a balanced mix of corporate securities underwriting, private financings and financial advisory services. We believe the number and dollar amount of underwritings and private placements in which we participate will contribute significantly to increased public and industry awareness of our company, and will result in increased demand for our investment banking and corporate advisory services.

We regularly participate in corporate securities distributions as a member of an underwriting syndicate or of a selling group in public offerings managed by other underwriters, including national and regional firms. Our syndicate department coordinates the distribution of co-managed equity underwritings, accepts invitations to participate in underwritings managed by other investment banking firms and allocates our selling allotments to our various sales units.

We also serve as placement agent or financial advisor in private placements of securities under a variety of fee structures depending on the amount and type of capital raised, including cash and equity contingent fees, cash and equity non-contingent fees, adjustable cash and equity fees or a combination of two or more of the foregoing. Our officers and directors often invest in the securities involved in private placements on the same basis as other investors, where suitable and permitted by applicable law and regulations. We believe these co-investments create an identity of interest with our investors, and thus benefit them.

Our financial advisory services include advising on mergers, acquisitions and divestitures, fairness opinions, and financing strategies. We also provide valuations, litigation support and financial consulting services. These financial advisory services are typically provided to emerging or middle market companies in the southwestern United States.

Proprietary Funds. SMH has organized a number of private equity funds for the purpose of purchasing, selling and investing in securities, primarily in equity or equity-linked securities, interest-bearing debt securities and debt securities convertible into common stock. We invest primarily in small to medium capitalization companies, both public and private, that we believe are either significantly undervalued relative to their growth potential, or that have substantial prospects for capital growth. Companies in which we invest belong to a number of industries, including environmental, industrial services, healthcare, technology, medical, life sciences and others.

We hold an interest in these funds and also earn management fees ranging from 1% to 2% per annum of total commitments, net assets or capital contributions during the investment period of the fund. We also receive incentive compensation ranging from 10% to 20% of the limited partnership profit above specified hurdle rates. We have agreed to compensate the managers of these funds and employees designated by the managers through a combination of salaries and incentives based on profitability of the funds. Over time, certain of our funds are expected to receive additional client funds. We account for our interests in all of these funds using the equity method, which approximates fair value.

Merchant Banking. Our merchant banking activities focus on providing private equity capital for middle-market growth companies. These middle-market companies comprise a broad range of industries, including business services, communications, computing, distribution, direct marketing of electronic financial services, energy, information technology, Internet, media entertainment, retail, specialty chemicals and biotechnology. These transactions may take a variety of forms, such as buyouts, growth buildups, expansion capital and venture capital financings.

Market Making and Principal Transactions. We make markets, buying and selling as principal, in securities quoted on Nasdaq or in the over-the-counter markets. In lieu of commissions, we create revenue in return for the risk we assume based on the markup or markdown of each transaction. Principal transactions with clients are generally effected at a net price within or equal to the current interdealer price plus or minus a markup or markdown. The trading department's objective is to facilitate sales to clients and to other dealers, not to generate profits based on trading for our own account.

Revenues from principal transactions depend on the general trend of prices and the level of activity in the securities market, employee skill in market-making activities and inventory size. Trading activities carried out as a principal require a commitment of capital, and create an opportunity for profit and risk of loss due to market fluctuations. At December 31, 2003, we made markets in the common stock or equity securities of 76 companies that were quoted on Nasdaq and in the over-the-counter market.

The level of positions carried in our trading accounts fluctuates significantly depending on the firm's assessment of economic and market conditions, the allocation of capital among various stocks, client demand, underwriting commitments and market trading volume. The aggregate value of our inventories is limited by certain net capital requirements under the Exchange Act. At December 31, 2003, trading inventories at SMH totaled $4.0 million.

We have established procedures designed to reduce the systemic risks of our proprietary trading activities. Our trading inventory positions and profit and loss statements are reviewed daily by senior management of SMH and quarterly by its board of directors. However, these procedures may not prevent losses, which could have a material adverse effect on SMH's business, financial condition, results of operations or cash flows.

Financial Planning. We provide specialized financial services and products to high net-worth individuals and institutions through our affiliation with a select group of independent registered representatives. The services provided by this division, which we call Sanders Morris Harris Partners ("SMHP"), include investment management, estate planning and retirement planning. The financial planners who affiliate with us are able to offer their clients a broad range of new investment opportunities through several exclusive investment programs offered by Sanders Morris Harris, Salient Capital Management, and SMH Capital Advisors.

Salient Capital Management, "Salient/PMT"

Financial Advisory Services. Salient/PMT provides financial advisory services to affluent families, families or individuals with concentrated stock positions, and smaller institutions. In analyzing a particular client's needs, we assess the client's goals and objectives, risk tolerance, and asset base. Then we develop an investment policy statement, which includes an asset allocation that focuses on diversification and risk-adjusted returns. Finally, we allocate capital from each asset class to one or more managers that we select based on assets under management, track record, management continuity, and adherence to style. Once a client's assets are allocated among a group of managers, we monitor performance and constantly assess whether a manager is managing the capital consistent with its mandate.

Family Office Services. Salient/PMT provides a variety of services typically offered in a family office to families with significant assets. These services entail providing advice as it relates to everyday and extraordinary issues relating to affluent families and include estate planning, assisting clients with business decisions, household budgeting, and capital project planning.

Trust, Asset Management and Related Services. Through Pinnacle Trust Co, LTA ("PMT"), we provide a variety of trust services, including investment management, estate settlement, retirement planning, mineral interest management, real estate, and other administrative services, such as custody of assets and record keeping. We meet with each client to develop asset management strategies that are consistent with the client's needs and investment objectives. Consideration is given to the client's financial and investment objectives, risk tolerance, investment restrictions and time horizon. We believe this total investment management approach provides clients with increased diversification, reduced risk and greater control over their portfolios.

We license trust accounting software that provides our clients with many additional benefits, including flexible statement packages and access to account information on the Internet through a link established between Salient/PMT's "home page" and the licensor of the software's database.

Salient/PMT's revenues are derived from both transactional commissioned-based arrangements and asset management and fiduciary fees based on a percentage of assets under administration. At December 31, 2003, PMT had approximately $583 million of assets under administration. The management fee charged is based on rate schedules that are changed from time to time. Rates vary depending on the services being provided and the amount of assets involved.

SMH Capital Advisors, "SMCA"

Asset Management Services. Through SMCA, we provide investment management services to investors who prefer managed accounts as a major part of their investment portfolios. The portfolios are tailored to each client's financial and investment objectives, with a risk tolerance profile that can range from maximum potential yield to maximum potential security. Through the Douglas-Noyes division of SMCA we provide asset management services with a focus on portfolios with a concentration on mid and large cap equities with a potential for growth. Our SMCA division in Ft. Worth invests primarily in fixed income securities. Our revenues are derived primarily from asset management and fiduciary fees based on a percentage of assets under administration.

Financial Planning Services. Through the Kissinger division of SMCA, we provide financial planning and investment management services to individuals. When preparing a financial portfolio for a client, we first determine the client's near term and long range goals and objectives. Then we prepare a thorough review of the person's assets, liabilities, income, expenses, taxes and savings. We also assess the client's insurance protection and estate planning. Finally, we develop an overall financial strategy and assist the client in its implementation. Our proprietary monitoring software enables us to produce regular financial updates for the client. The quarterly reports provide the client and us with periodic feedback on the progress towards realizing the client's financial goals. Kissinger derives revenues from fees charged to the clients for the preparation of financial plans and for monitoring services. Additionally, Kissinger earns commissions from investment and insurance products sold to the clients.

For financial information with respect to our two business segments, see Note 18 to the Consolidated Financial Statements.

Clients

Other than the proprietary funds, our investment service business is conducted on an individual client basis. In many cases, one of our registered broker employees holds a limited power of attorney permitting discretionary agency and certain other transactions on a client's behalf. Our officers and directors often invest in the same securities as our retail and institutional clients, where suitable and as permitted by applicable law and regulations. We believe co-investment creates an identity of interest that is generally beneficial, particularly in investments we develop or where we play a major ongoing role.

Clients of our broker-dealer subsidiary, SMH, vary according to the nature of the services provided. Our retail brokerage services are generally focused on high net worth individuals. SMH's investment banking, underwriting, investment research and principal transaction activities are targeted at emerging and middle market companies throughout the United States. Our institutional and prime brokerage services are offered to institutions and hedge funds throughout the United States, Europe and Asia. These institutional clients consist mostly of pension funds, money managers, mutual and hedge funds, insurance companies, commercial banks and thrift companies.

Salient/PMT provides services to institutions, high net worth individuals and their estates and trusts, 401(k) and other employee-directed company sponsored retirement plans and charitable and other non-profit corporations.

Our investment advisory and financial planning subsidiary, SMCA, provides asset management and financial planning services to clients consisting mainly of mid to high net worth investors.

Marketing

The marketing efforts of SMH are conducted throughout SMH's 14 offices and through its independent registered representatives who affiliate with SMH through its SMHP division. SMH targets its client groups through mailings, telephone calls, in-person presentations and firm-sponsored workshops. Due to the nature of our business, our regional name recognition and the reputation of our management, business is obtained through referrals from other investment bankers or initiated directly by the client, as well as through senior level calling programs.

Salient/PMT conducts its marketing and business development efforts on a company-wide basis. All Salient/PMT employees are encouraged to be actively involved in business development efforts through maintenance of professional and personal relationships and active involvement in community events. Salient/PMT markets to specific client groups through mailings, telephone calls, multi-media client presentations and company-sponsored or co-sponsored workshops and seminars. Additionally, Salient/PMT has entered into strategic alliances with a major credit union, a regional accounting firm and a regional bank that provide for sharing of expenses and the payment of referral fees for new business.

SMCA conducts its marketing and business development efforts to specific client groups through mailings, telephone calls, multi-media client presentations, alliances with professional organizations and company-sponsored or co-sponsored workshops and seminars. The seminars are sponsored by the firm, local employers, government agencies, and local colleges and universities.

We believe cross-selling opportunities exist among our various subsidiaries based on the relationships developed by the individual companies.

Existing and potential clients can also gain a variety of information about our firm and services we provide through our websites at www.smhgroup.com; www.smhhou.com; www.salientpartners.com; www.smhpartners.com; www.pinnacletrust.com; www.cummermoyers.com and www.kissingernet.com.

Relationship with Clearing Brokers

Our broker-dealer subsidiary uses the services of clearing brokers. Currently, we clear transactions, and carry accounts for clients, primarily through Pershing LLC, a member of BNY Securities Group and a subsidiary of The Bank of New York under a fully disclosed clearing arrangement. Pershing serves as clearing broker in most transactions; however, we also use other clearing brokers. These clearing brokers also provide us with information necessary to generate commission runs, transaction summaries and data feeds for various reports, including compliance and risk management, execution reports, trade confirmations, monthly account statements, cashiering functions and handling of margin accounts. We believe these arrangements produce clearing costs that are competitive within the industry.

We have uncommitted financing arrangements with our clearing brokers that finance our customer accounts, certain broker-dealer balances and firm trading positions. Although these customer accounts and broker-dealer balances are not reflected on our balance sheet for financial accounting reporting purposes, we have generally agreed to indemnify these clearing brokers for losses they may sustain in connection with the accounts. Therefore, we retain risk on these accounts. We are required to maintain certain cash or securities on deposit with our clearing broker.

Our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act are made available free of charge on our website, www.smhgroup.com, as soon as reasonably practicable after we electronically file such material with, or furnish it to the SEC.

Effects of an Improvement in the Overall Stock Market

Our financial service business is affected by general economic conditions. The improvement in the economy, as well as in the overall stock market has had a positive impact on our equity commission revenues and on underwriting fees derived from public offerings. During 2003, the decline in interest rates caused an increase in residential loan refinancing, which had a positive impact on that portion of our business that derives its income from fixed-income securities. We believe that a stronger economy will be favorable to our equity business.

Our revenues relating to asset-based advisory services and managed accounts are typically from fees based on the market value of assets under management. Consequently, significant fluctuations in the values of securities, which can occur with changes in interest rates or changes in other economic factors, may materially affect the amount of assets under management, and thus, our revenues and profitability.

Competition

Our financial services business and the securities business in general are highly competitive. The principal competitive factors influencing our financial services business are:

- professional staff,
- reputation in the marketplace,
- existing client relationships, and
- ability to commit capital to client transactions and a mix of market capabilities.

We compete directly with national and regional full service broker-dealers and, to a lesser extent, with discount brokers, dealers, and other investment banking firms, investment advisors and commercial banks. We also compete for asset management and fiduciary services with commercial banks, private trust companies, mutual fund companies, insurance companies and others. The financial services industry has become considerably more concentrated as many securities firms have either ceased operations or been acquired by or merged into other firms. Many of these larger firms have significantly greater financial and other resources than we do and can offer their customers more product offerings, lower pricing, broader research capabilities, access to international markets and other products and services we do not offer, which may give these firms a competitive advantage over us.

Government Regulation

The securities industry is one of the nation's most extensively regulated industries. The SEC is responsible for carrying out the federal securities laws and serves as a supervisory body over all national securities exchanges and associations. The regulation of broker-dealers has to a large extent been delegated by the federal securities laws to Self Regulatory Organizations, called "SROs". These SROs include, among others, all the national securities and commodities exchanges and the NASD. Subject to approval by the SEC and certain other regulatory authorities, SROs adopt rules that govern the industry and conduct periodic examinations of the operations of our broker-dealer subsidiary. Our broker-dealer subsidiary is also subject to regulation under the laws of the states, Puerto Rico and certain foreign countries in which it is registered to conduct securities, investment banking, insurance or commodities business.

As a registered broker-dealer, our brokerage subsidiary is subject to certain net capital requirements of Rule 15c3-1 under the Exchange Act. The net capital rules, which specify minimum net capital requirements for registered broker-dealers, are designed to measure the financial soundness and liquidity of broker-dealers. Failure to maintain the required net capital may subject a firm to suspension or revocation of registration by the SEC and suspension or expulsion by other regulatory bodies, and ultimately may require its liquidation. Further, a decline in a broker-dealer's net capital below certain "early warning levels," even though above minimum capital requirements, could cause material adverse consequences to the broker-dealer.

As a registered investment advisor under the Investment Advisers Act, the Company is subject to the requirements of regulations under both the Investment Advisers Act and certain state securities laws and regulations. Such requirements relate to, among other things, (1) limitations on the ability of investment advisors to charge performance-based or non-refundable fees to clients, (2) record-keeping and reporting requirements, (3) disclosure requirements, (4) limitations on principal transactions between an advisor or its affiliates and advisory clients, and (5) general anti-fraud prohibitions.

Our trust subsidiary, PMT, operates in a highly regulated environment and is subject to extensive supervision and examination by Texas regulatory agencies. As a Texas chartered trust company, PMT is subject to the Texas Trust Company Act, the rules and regulations promulgated under the act and supervision by the Texas Banking Commissioner. These laws are intended primarily for the protection of PMT's clients, rather than for the benefit of investors.

Employees

At December 31, 2003, we had 317 employees. Of these, 54 were engaged in retail brokerage, 47 in institutional sales and trading, 12 in fixed income sales, 30 in investment banking, 21 in securities analysis and research, 38 in prime brokerage, 22 in financial advisory and trust services, 17 in financial planning, 27 in asset management, six in systems development and 43 in accounting, administration and support operations. None of our employees are subject to collective bargaining agreements. We believe our relations with our employees generally are good.

Risk Management

As a financial and investment firm, our operating results are adversely affected by a number of factors, which include:

- the risk of losses resulting from the ownership or underwriting of securities;
- the risks of trading securities for ourselves (i.e., principal activities) and for our customers;
- reduced cash inflows from investors into our asset management businesses;
- counterparty failure to meet commitments;
- customer default and fraud;
- customer complaints;
- employee errors, misconduct and fraud (including unauthorized transactions by traders);
- failures in connection with the processing of securities transactions;
- litigation and arbitration;
- the risks of reduced revenues in periods of reduced demand for public offerings or reduced activity in the secondary markets; and
- the risk of reduced fees we receive for selling securities on behalf of our customers (i.e., underwriting spreads).

Item 2. *Properties*

We lease office facilities in Houston (two locations), Ft. Worth area (two locations), and Dallas, Texas; New York City and Garden City, New York; Morris Plains, New Jersey; Tulsa, Oklahoma, Hunt Valley, Maryland; Denver, Colorado; Jackson, Mississippi; Los Angeles and San Francisco, California aggregating approximately 197,000 square feet. One of our Houston leases expires in 2007, and the other in 2010. Our other leases expire between 2003 and 2014 including the Tulsa lease in 2004 and the Jackson lease in 2005, the Dallas, Denver and Hunt Valley leases in 2006, the Garden City and San Francisco leases in 2007, the Los Angeles lease in 2012, the Ft. Worth lease in 2013 and the New York City lease in 2014. The leases are on rental and other terms that we believe are commercially reasonable. We believe our existing facilities are well maintained and adequate for existing and planned operations.

Item 3. *Legal Proceedings*

We are a party to various legal proceedings that are of an ordinary or routine nature incidental to our operations. We believe we have adequately reserved for such litigation matters and that they will not have a material adverse effect on our consolidated financial condition, results of operations or cash flows.

Item 4. *Submission of Matters to a Vote of Security Holders*

There were no matters submitted to a vote of our security holders during the fourth quarter ended December 31, 2003.

PART II.

Item 5. *Market for the Registrant's Common Equity and Related Stockholder Matters*

Our common stock trades on the Nasdaq National Market tier of The Nasdaq Stock Market under the symbol "SMHG." The following table set forth the quarterly high and low sale prices for our common stock during 2003 and 2002 for the calendar quarters indicated, each as reported on the Nasdaq National Market:

Calendar Period	High	Low
2003:		
First Quarter	$9.89	$7.18
Second Quarter	$10.09	$8.32
Third Quarter	$9.95	$8.38
Fourth Quarter	$12.95	$8.70
2002:		
First Quarter	$6.45	$4.50
Second Quarter	$6.50	$5.75
Third Quarter	$6.60	$5.50
Fourth Quarter	$8.93	$5.75

At March 4, 2004, there were approximately 254 record holders of our common stock.

Dividend Policy

Our board of directors intends to declare quarterly dividends on our common stock. During 2002, the quarterly dividend payment was $0.025 per share (an annual amount of $0.10 per share). During 2003, the quarterly dividend payment was $0.03 per share (an annual amount of $0.12 per share). In February 2004, the board of directors declared a cash dividend for the first quarter of 2004 in the amount of $0.0375 per share. Our declaration and payment of future dividends is subject to the discretion of our board of directors. In exercising this discretion, the board of directors will take into account various factors, including general economic and business conditions, our strategic plans, our financial results and condition, our expansion plans, any contractual, legal and regulatory restrictions on the payment of dividends, and such other factors the board considers relevant.

Item 6. ***Selected Financial Data***

The following data should be read together with the Consolidated Financial Statements and their related notes and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included later in this Report.

	Year Ended December 31, (in thousands except share and per share amounts)				
	2003	**2002**	**2001**	**2000**	**1999**
Statement of Operations					
Total revenues	$ 103,934	$ 82,377	$ 54,651	$ 43,866	$ 8,430
Income (loss) from continuing operations	10,416	5,399	1,066	2,111	(3,725)
Loss from discontinued operations, net of tax	-	-	(121)	(11,734)	(969)
Net income (loss)	$ 10,416	$ 5,399	$ 945	$ (9,623)	$ (4,694)
Adjusted net income (loss) (1)	$ 10,416	$ 5,399	$ 3,117	(8,056)	$ (4,165)
Diluted earnings (loss) per share:					
From continuing operations	$ 0.59	$ 0.32	$ 0.07	$ 0.15	$ (0.55)
From discontinued operations	-	-	(0.01)	(0.84)	(0.14)
Net earnings (loss) per share	$ 0.59	$ 0.32	$ 0.06	$ (0.69)	$ (0.69)
Adjusted net earnings (loss) per share (1)	$ 0.59	$ 0.32	$ 0.20	$ (0.58)	$ (0.61)
Weighted average shares outstanding - diluted	17,622,443	16,918,432	15,958,879	13,951,787	6,828,378

(1) Represents previously reported net income (loss) and net earnings (loss) per common share, adjusted for the exclusion of goodwill amortization. Beginning in 2002, new accounting standards eliminated the amortization of goodwill.

	As of December 31,				
	2003	**2002**	**2001**	**2000**	**1999**
	(in thousands except per share amounts)				
Balance Sheet Data:					
Cash and cash equivalents	$ 32,590	$ 34,890	$ 30,410	$ 25,059	$ 10,495
Securities	35,478	20,059	13,844	13,818	89,052
Total assets	137,002	117,323	105,309	99,214	297,907
Total liabilities	21,106	15,591	8,975	9,102	240,330
Minority interests	1,043	421	51	186	-
Shareholders' equity	114,853	101,311	96,283	89,926	57,577
Cash dividend declared per common share	$0.12	$0.10	-	-	-

Item 7. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read together with the Consolidated Financial Statements and their related notes and "Selected Financial Data" included in this Report.

General

We provide diversified financial services through our subsidiaries, including institutional, prime and retail brokerage, investment banking, merchant banking, trust related services, asset management and financial planning. All of these activities are highly competitive and are sensitive to many factors outside our control, including those factors listed under "Factors Affecting Forward-Looking Statements."

We closely monitor our operating environment to enable us to respond promptly to market cycles. In addition, we seek to lessen earnings volatility by controlling expenses, increasing fee-based business and developing new revenue sources. Nonetheless, operating results of any individual period should not be considered representative of future performance.

In January 2002, the former institutional equity unit of Sutro & Co., (the "New Institutional Group") joined the Company. The New Institutional Group complemented our existing institutional division by increasing our sales and trading base and by adding equity research in areas that we did not previously cover.

In April 2002, the investment professionals of Douglas-Noyes joined the Company. Douglas-Noyes provides asset management services with a focus on portfolios having a concentration on large cap equities with a potential for growth.

In May 2003, the Company acquired a 50% ownership interest in the Salient companies and a 23.15% profits interest in the advisor to The Endowment Fund, a related entity. Based in Houston, Texas, the Salient companies provide investment advisory services to individuals and institutions. The Endowment Fund is a diversified fund of funds using fund managers that specialize in a variety of investment approaches.

In conjunction with the Salient acquisition, Pinnacle Management & Trust Co., our trust subsidiary, was contributed to Salient and was renamed Pinnacle Trust Co., LTA.

In December 2003, the Company acquired the Tulsa, Oklahoma branch office of U.S. Bankcorp Piper Jaffray Inc. The Tulsa office provides retail brokerage services to its clients.

The historical financial information contained in this document includes the results of operations and financial position of our current businesses from the dates of acquisition, except for our discontinued businesses.

Components of Revenues and Expenses

Revenues. Our revenues are comprised primarily of (1) commission revenue from retail, prime and institutional brokerage transactions, fees from asset-based advisory services, and principal and agent transactions, (2) investment banking revenue from corporate finance fees, mergers and acquisitions fees and merchant banking fees and (3) fees from asset management, financial planning and fiduciary services. We also earn interest on cash and dividends received from the equity and fixed income securities held in our corporate capital accounts and have realized and unrealized gains (or losses) on securities in our inventory account.

Expenses. Our expenses consist of (1) compensation and benefits, (2) brokerage and clearing costs and (3) other expenses. Compensation and benefits is our largest expense item and includes wages, salaries, and benefits. During 2003, compensation and benefits represented 71% of total expenses and 62% of total revenues. Compensation and benefits have both a variable component based on revenue production, and a fixed component. The variable component includes institutional and retail sales commissions, bonuses, overrides and other incentives. Retail and institutional commissions are based on competitive commission schedules. The investment banking group and the research group receive a salary and discretionary bonus as compensation. The fixed component includes administrative and executive salaries, payroll taxes, employee benefits and temporary employee costs.

Brokerage and clearance expenses include clearing and trade execution costs associated with the retail, prime and institutional brokerage business at SMH. SMH clears its transactions primarily through Pershing LLC, a member of BNY Securities Group and a subsidiary of The Bank of New York and through other clearing brokers.

Other expenses include (1) occupancy and equipment expenses, such as rent and utility charges for facilities, and (2) communications and data processing expense, such as third-party systems, data, and software providers.

Overview

Our financial services business is affected by general economic conditions. The improvement in the economy, as well as in the overall stock market has had a positive impact on our equity commission revenues, on underwriting fees derived from public offerings, and on advisory fees from private placements. During 2003, the decline in interest rates during the first three quarters led to an increase in residential loan refinancing, which had a positive impact on that portion of our business that derives its income from mortgage-backed fixed-income securities.

Our revenues relating to asset-based advisory services and managed accounts are typically from fees based on the market value of assets under management. The overall increase in equity prices resulted in growth in the values of our customers' investment portfolios, which in turn led to higher management fees for the Company during 2003. The improved stock market has caused many of our customers to rebalance their investment portfolios, thereby reducing concentrations in money market instruments and increasing exposure to equity and other securities with a greater potential for growth.

We have organized 13 private equity funds for the purpose of investing in public and private companies that we believe are either significantly undervalued relative to their growth potential, or that have substantial prospects for capital growth. We invest in these funds along with our clients and earn management fees based on capital commitments, net assets or capital contributions. We also receive incentive compensation of a portion of the profit if the profit exceeds specified hurdle rates. The improvement in the overall stock market, as well as in individual investment positions owned by the private equity funds provided the Company with realized and unrealized gains from its ownership interests and incentive compensation due to fund performance.

We also invest a portion of our excess cash in public equity and debt securities that we feel are undervalued. Additionally, we may receive warrants as a part of our compensation for investment banking services. During 2003, our investment portfolios and warrants increased in value, which contributed to an overall gain in principal revenues during the year.

We have expanded both the range and depth of services offered to our clients through a combination of acquisitions and internal expansion. This growth has necessitated that we add additional personnel, as well as production-related incentive compensation plans. We have also improved and expanded our infrastructure including facilities, technology, and information services, to enable us to better compete with other firms that offer services similar to ours. While our compensation and other costs increased in amount in 2003, they declined as a percentage of revenues.

Results of Operations

Year Ended December 31, 2003 Compared to Year ended December 31, 2002

The May 2, 2003 acquisition of a 50% ownership interest in the Salient companies and a 23.15% profits interest in the advisor to The Endowment Fund, along with the Company's contribution of a 50% ownership interest in PMT to the former owners of Salient is reflected in our operating results for 2003 from the date of the transaction. The results for 2002 reflect PMT for the entire year.

Total revenues increased to $103.9 million in 2003 from $82.4 million in 2002 due to increases in (i) equity commission revenues from prime brokerage services, (ii) fees earned from investment banking transactions, (iii) fees earned from our asset management business and (iv) gains on our investment portfolios and from other principal transactions. These revenue increases were partially the result of a favorable operating environment, driven by an improving economy and stock market. Additionally, the Company's abilities to raise capital to facilitate banking transactions, provide back office services necessary for prime brokerage operations and manage investment portfolios have resulted in higher revenues in 2003. Total expenses increased to $91.0 million in 2003 from $73.5 million in 2002, primarily due to additional personnel and the variable and incentive components of our compensation expense related to the additional revenues. Equity in income of limited partnerships increased to $4.3 million in 2003 from $2.4 million in 2002, principally due to increases in the values of securities held in the investment portfolios of the limited partnerships managed by the Company. Net income increased to $10.4 million, or $0.59 per diluted share in 2003, compared to $5.4 million, or $0.32 per diluted share in 2002.

Commission revenue increased to $51.2 million in 2003 from $44.7 million in 2002 primarily due to growth in revenues from prime brokerage services provided to hedge funds. The Company's back office and trading services were developed to appeal to relatively small hedge funds. Based on the improved securities market during 2003 and the success of prime brokerage hedge fund efforts, we were able to increase both the number of clients and their trading volume in 2003 as compared to the prior year. Investment banking revenues increased to $24.5 million in 2003 from $16.3 million in 2002, principally due to an increase in underwriting and management fees derived from public offerings, as well as increases in fees from private placements, both of which were mainly attributable to the improving equity market in 2003. The Company's focus on the energy, life sciences, and retail industries has positioned us to assist our customers in those areas with their money-raising needs.

The increase in employee compensation and benefits to $64.4 million in 2003 from $52.1 million 2002 reflects the higher commission and incentive compensation paid to employees who were responsible for the higher revenues. The increase in revenues is also responsible for higher communications, clearing and execution costs during 2003.

The effective tax rate was 39.5% in 2003 and 40.0% in 2002. The effective tax rate exceeds the federal statutory income tax rate primarily as a result of state income taxes.

Results of Operations

Year Ended December 31, 2002 Compared to Year Ended December 31, 2001

The January 2, 2002 addition of the New Institutional Group is reflected in our operating results for the year ended December 31, 2002, but not for the year ended December 31, 2001. Kissinger was acquired on April 5, 2001; hence its operating results for 2001 are included from the date of acquisition. The results for 2002 reflects Kissinger for the entire period.

Total revenues increased 51% to $82.4 million in 2002 from $54.7 million in 2001, primarily due to an increase in revenues resulting from the addition of the New Institutional Group, the 2001 acquisition of Kissinger and revenue growth from prime brokerage services. Total expenses increased 32% to $73.5 million in 2002 from $55.6 million in the previous year, principally due to variable and incentive components of our compensation expenses related to the increase in revenues, and to the increase in other expenses associated with the addition of the New Institutional Group and the acquisition of Kissinger. Equity in income of limited partnerships declined from $3.7 million in 2001 to $2.4 million in 2002. This decline was caused by a reduction in the amount of the Company's share of increases in the values of securities held in the investment portfolios of the limited partnerships managed by the Company. Net income for the year ended December 31, 2002 increased to $5.4 million from $945,000 in 2001. Approximately $2.2 million of the increase in net income was attributable to goodwill amortization incurred in 2001 without any corresponding amortization charge during 2002. Diluted earnings per share from continuing operations were $0.32 per share in 2002, compared to $0.07 per share for 2001.

Commission revenue increased to $44.7 million in 2002 from $24.5 million in 2001, primarily as a result of the addition of the New Institutional Group and growth from prime brokerage services. Principal transactions revenue totaled $9.6 million in 2002, versus $7.4 million in 2001. During 2001, the Company recognized permanent impairment losses on its securities available for sale portfolio of $1.3 million as a result of the major correction in the equity markets that occurred during that year. Additionally, performance in the Company's investment and warrant portfolios improved in 2002 compared to 2001 primarily from the slightly improved securities markets in 2002 as compared to the prior year. Investment banking revenue increased to $16.3 million in 2002 from $12.1 million in 2001, primarily due to increases in advisory fees and fees earned from the Company's participation in various syndicates that underwrite and distribute securities. During 2002, the Company recognized fees totaling $5.0 million attributable to the completion of a single healthcare-related transaction, 50% of this fee was shared with a minority interest. Fiduciary, custodial and advisory fees increased to $7.5 million in 2002 from $6.4 million in 2001, mainly due to an increase in fees earned from asset-based advisory services. Interest and dividend income declined to $1.9 million in 2002 from $2.4 million in 2001 reflecting a decline in interest rates from 2001 to 2002. Other income increased to $2.5 million in 2002 from $1.7 million in 2001, due to an increase in interest earned on the Company's cash balances and customer credit balances at the Company's clearing brokers.

For the year ended December 31, 2002, employee compensation and benefits increased to $52.1 million from $36.1 million in 2001, as a result of the addition of the New Institutional Group, the acquisition of Kissinger and growth in revenues from prime brokerage services. Floor brokerage, exchange and clearance fees increased to $4.3 million in 2002 from $3.2 million in 2001, reflecting increased clearing and execution costs resulting from the additional trading volume attributable to the New Institutional Group and to growth in revenues from prime brokerage. Communication and data processing costs totaled $4.4 million in 2002, compared to $3.7 million in 2001 reflecting the increase in personnel and trading volumes related to the New Institutional Group. Occupancy costs increased to $4.5 million in 2002 from $3.8 million in 2001, primarily due to the additional rent expense for office leases for the New Institutional Group and Kissinger. Due to adoption of SFAS 142 on January 1, 2002, the Company no longer amortizes goodwill. During 2001, goodwill amortization totaled $2.2 million. Other general and administrative expenses increased to $8.2 million from $6.6 million in 2001, mainly due to the addition of the New Institutional Group and the acquisition of Kissinger.

The effective tax rate from operations was 40% for the year ended December 31, 2002, compared to 64.7% for the year ended December 31, 2001. The effective tax rate exceeds the federal statutory income tax rate primarily as a result of state income taxes, and, for 2001, nondeductible goodwill amortization.

Losses from discontinued operations, net of tax, were $121,000 in 2001, reflecting an additional provision to record uncollectible commissions receivable at Spires Financial, a former subsidiary of the Company.

Liquidity and Capital Resources

Cash Requirements

The Company's funding needs consist of (i) funds necessary to maintain current operations, (ii) capital expenditure requirements, and (iii) funds used for acquisitions.

The Company and its subsidiaries have obligations under operating leases that expire by 2014 with initial noncancelable terms in excess of one year. Aggregate annual rentals for office space and computer and office equipment are as follows (in thousands):

2004	$ 3,018
2005	3,577
2006	3,715
2007	3,307
2008	2,428
Thereafter	12,226
Total minimum rental payments	$ 28,271

Operating expenses consist of compensation and benefits, brokerage and clearing costs and other expenses. These expenses are primarily dependent on revenues, and with the exception of obligations for office rentals, should require a limited amount of capital in addition to that provided by revenues during 2004. Currently, obligations for non-cancelable office leases total $3.0 million during 2004. Funds required for other working capital items such as receivables, securities owned, and accounts payable, along with expenditures to purchase treasury stock are not expected to exceed $10.0 million. Capital expenditure requirements are expected to total between $3.0 million and $5.0 million during 2004, mainly consisting of leasehold improvements, furniture, and computer equipment and software. Funds needed for acquisitions will depend on the completion of transactions that may not be identifiable until such time as the acquisition is completed.

We intend to satisfy a large portion of our funding needs with our own capital resources, consisting largely of internally generated earnings and liquid assets. At December 31, 2003, we had approximately $32.6 million in cash and cash equivalents, which together with liquid assets, consisting of receivables from broker-dealers and clearing organizations, deposits with clearing brokers, marketable securities owned, and securities available for sale totaled $45.4 million.

Sources and Uses of Cash

For the year ended December 31, 2003, net cash used in operations totaled $1.5 million compared to net cash provided by operations of $10.0 million during 2002.

Net income increased to $10.4 million in 2003 from $5.4 million during 2002, while working capital and other adjustments used $11.9 million during 2003 versus providing $4.6 million in 2002.

Accounts receivable increased $3.2 million during 2003 compared to a decline of $1.7 million in 2002. A portion of this increase is related to higher investment banking and asset management revenues recorded but not collected during the last quarter of 2003 compared to the same period in 2002. Management fees receivable from the limited partnerships managed by the Company also increased during 2003, primarily due to our decision to delay collection of the management fees until two of the partnerships liquidate sufficient investments to provide the funds necessary to pay the management fees.

Securities owned increased by $15.3 million during 2003 compared to $4.8 million during 2002. The increase during 2003 consists of both new investments and net realized and unrealized gains on the investment portfolio. The realized gains are generally reinvested in the portfolio.

Accounts payable and accrued liabilities increased by $4.0 million during 2003 compared to $6.3 million during 2002, primarily due to increases in bonuses and other incentive compensation related to the higher revenues during 2003.

Capital expenditures for 2003 were $1.4 million compared to $3.0 million in 2002, mainly for the purchase of leasehold improvements, furniture, and computer equipment and software necessary for our growth. During 2003, we reacquired 21,154 of our common shares at a total cost of approximately $183,000.

During 2003, we paid approximately $1.7 million, net of cash on hand, to acquire an interest in the Salient companies and a related entity, the advisor to The Endowment Fund; and paid $377,000 to acquire the Tulsa, Oklahoma branch office of U.S. Bancorp Piper Jaffray Inc.

At December 31, 2003, SMH, our registered broker-dealer subsidiary, was in compliance with the net capital requirements of the SEC's Uniform Net Capital Rules and had capital in excess of the required minimum. PMT was in compliance with the Texas Department of Banking's net capital requirement and had capital in excess of the required minimum.

We are a party to various legal proceedings that are of an ordinary or routine nature incidental to our operations. We believe we have adequately reserved for such litigation matters and that they will not have a material adverse effect on our consolidated financial condition, results of operations, or cash flows.

Our board of directors declared a cash dividend for each quarter of 2003, in the amount of $0.03 per share of common stock (an annual amount of $0.12 per share.) On February 18, 2004, our board declared a cash dividend for the first quarter of 2004 in the amount of $0.0375 per share of common stock. The cash dividend will be payable on April 15, 2004, to common stockholders of record at the close of business on April 1, 2004. While we intend to declare dividends in subsequent quarters, any future dividends will be at the discretion of our board of directors after taking into account various factors, including general economic and business conditions, our strategic plans, our financial results and condition, our expansion plans, any contractual, legal or regulatory restrictions on the payment of dividends, and such other factors our board considers relevant.

Critical Accounting Policies/Estimates

Valuation of Not Readily Marketable Securities. Securities not readily marketable include investment securities (a) for which there is no market on a securities exchange or no independent publicly quoted market, (b) that cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933, or (c) that cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities or to the Company. Securities not readily marketable consist primarily of investments in private companies, limited partnerships, equities, options and warrants.

Generally, investments in shares of public companies are valued at a discount of up to 30% to the closing market price on the balance sheet date if the shares are not readily marketable. Investments in unregistered shares of public companies are valued at a 30% discount from the most recent sales price of registered shares, except in cases where the securities may be sold pursuant to a currently effective registration statement or an exemption from registration and there exists sufficient trading volume in the securities, in which case the market price is used. The discounts reflect liquidity risk and contractual or statutory restrictions on transfer. Preferred stock of a public company is carried at its liquidation preference. Investments in private companies are valued at the purchase price until there exists a basis for revaluation. Revaluation may result from a subsequent public offering or private placement, an event that has occurred indicating valuation increase or impairment, or other pertinent factors and events. Investments in limited partnerships are accounted for using the equity method, which approximates fair value.

Investments in not readily marketable securities, marketable securities with insufficient trading volumes and restricted securities have been valued at their estimated fair value by the Company in the absence of readily ascertainable market values. These estimated values may differ significantly from the values that would have been used had a readily available market existed for these investments. Such differences could be material to the financial statements. At December 31, 2003 and 2002, the Company's investment portfolios included investments totaling $24.2 million and $14.6 million, respectively, whose values had been estimated by the Company in the absence of readily ascertainable market values.

Goodwill. In June 2001, the FASB issued Statement No. 142 (SFAS No. 142), *Goodwill and Other Intangible Assets.* SFAS No. 142 became effective for the Company on January 1, 2002. Goodwill is no longer amortized under SFAS No. 142 but is tested for impairment using a fair value approach.

The Company uses several methods to value the reporting units, including discounted cash flows, comparisons with valuations of public companies in the same industry, and industry guidelines for the valuation of private companies in a similar business. The Company determined that the fair values of the reporting units exceeded their carrying values; therefore goodwill does not appear to be impaired. SFAS No. 142 requires SMHG to perform goodwill impairment tests on at least an annual basis. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings.

Factors Affecting Forward-Looking Statements

This Annual Report on Form 10-K includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, (the "Acts"). These forward-looking statements may relate to such matters as anticipated financial performance, future revenues or earnings, business prospects, projected ventures, new products, anticipated market performance and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. To comply with the terms of the safe harbor, the Company cautions readers that a variety of factors could cause the Company's actual results to differ materially from the anticipated results or other expectations expressed in the forward-looking statements. These risks and uncertainties, many of which are beyond the Company's control, include, but are not limited to (1) trading volume in the securities markets; (2) volatility of the securities markets and interest rates; (3) changes in regulatory requirements that could affect the demand for the Company's services or the cost of doing business; (4) general economic conditions, both domestic and foreign, especially in the regions where the Company does business; (5) changes in the rate of inflation and related impact on securities markets; (6) competition from existing financial institutions and other new participants in the securities markets; (7) legal developments affecting the litigation experience of the securities industry; (8) successful implementation of technology solutions; (9) changes in valuations of the Company's trading and warrant portfolios resulting from mark-to-market adjustments; (10) dependence on key personnel and (11) demand for the Company's services. The Company does not undertake any obligation to publicly update or revise any forward-looking statements.

The improvement in the economy, and the overall stock market has had a positive impact on our equity commission revenues and on underwriting fees derived from public offerings. Additionally, as stock prices rise, our assets under management typically increase in value, which, in turn results in higher asset management fees. During 2003, the decline in interest rates caused an increase in residential loan refinancing, which had a positive impact on that portion of our business that derives its income from fixed income securities. We believe that a stronger economy will be favorable to our equity business.

Effects of Inflation

Historically, inflation has not had a material effect on our consolidated financial position, results of operations or cash flows; however, the rate of inflation can be expected to affect our expenses, such as employee compensation, occupancy and equipment. Increases in these expenses may not be readily recoverable in the prices that we charge for our services. Inflation can have significant effects on interest rates that in turn can affect prices and activities in the financial services market. These fluctuations could have an adverse impact on our financial services operations.

Item 7A. *Quantitative and Qualitative Disclosures About Market Risk*

Market Risks

The following discussion relates to our market risk sensitive instruments as of December 31, 2003, and thus, includes such instruments held by SMH, Salient/PMT and SMHG.

SMH

SMH's trading equity securities are marked to market on a daily basis. At December 31, 2003, SMH's trading equity securities were recorded at a fair value of $3.9 million. These trading equity securities are subject to equity price risk. This risk would amount to $390,000 based on a potential loss in fair value from a hypothetical 10% decrease in the market value of such equity securities. The actual equity price risk related to the trading equity securities may differ substantially.

SMH's market making, investing, and underwriting activities often involve the purchase, sale, or short sale of securities and expose its capital to significant risks, including market risk, equity price risk, and credit risk. Market risk represents the potential loss we may incur as a result of absolute and relative price movements, price volatility, and changes in liquidity in financial instruments due to many factors over which we have virtually no control. SMH's primary market risk arises from the fact that it owns a variety of investments that are subject to changes in value and could result in material gains or losses. SMH also engages in proprietary trading and makes dealer markets in equity securities. In doing this, SMH may be required to maintain certain amounts of inventories in order to facilitate customer order flow. SMH is exposed to equity price risk due to changes in the level and volatility of equity prices primarily in Nasdaq and over-the-counter markets. Changes in market conditions could limit SMH's ability to resell securities purchased or to purchase securities sold short. Direct market risk exposure to changes in foreign exchange rates is not material.

SMH seeks to cover its exposure to market and equity price risk by limiting its net long and short positions and by selling or buying similar instruments. In addition, trading and inventory accounts are monitored on an ongoing basis, and SMH has established position limits. Position and exposure reports are prepared at the end of each trading day and are reviewed by traders, trading managers and management personnel. These reports show the amount of capital committed to various issuers and industry segments. Securities held in SMH's investment portfolio are guided by an investment policy and are reviewed on a regular basis.

Credit risk represents the potential loss due to a client or counterparty failing to perform its contractual obligations, such as delivery of securities or payment of funds; or the value of collateral held to secure obligations proving to be inadequate as related to the Company's margin lending activities. This risk depends primarily on the creditworthiness of the counterparty. SMH seeks to control credit risk by following an established credit approval process, monitoring credit limits and requiring collateral where appropriate.

SMH monitors its market and counterparty risk on a daily basis through a number of control procedures designed to identify and evaluate the various risks to which it is exposed. SMH has established various committees to assess and to manage risk associated with its investment banking and other activities. The committees review, among other things, business and transactional risks associated with potential clients and engagements. SMH seeks to control the risks associated with its investment banking activities by review and approval of transactions by the relevant committee, prior to accepting an engagement or pursuing a material investment transaction.

At December 31, 2003, SMH's securities were recorded at a fair value of $21.5 million, including $3.9 million in marketable securities, $10.7 million representing SMH's investments in limited partnerships and $6.9 million representing other not readily marketable securities.

We do not act as dealer, trader, or end-user of complex derivative contracts such as swaps, collars and caps. However, SMH does act as a dealer and trader of mortgage-derivative securities, called collateralized mortgage obligations (CMOs or REMICs). Mortgage-derivative securities redistribute the risks associated with their underlying mortgage collateral by redirecting cash flows according to specific formulas or algorithms to various tranches or classes designed to meet specific investor objectives.

Salient/PMT

At December 31, 2003, PMT had equity securities under management with a fair value of $583 million. Salient/PMT's fee income for the year ended December 31, 2003 would have been reduced by approximately $208,000 assuming a hypothetical 10% decrease in the value of its equity securities under management. PMT's fee income could also be reduced from changes in interest rates to the extent that such changes reduce the carrying value of securities under management. Additionally, PMT's securities available for sale are recorded at a fair value of approximately $3.2 million at December 31, 2003. These securities have an original cost of $3.3 million, and are subject to equity price risk. At December 31, 2003, the unrealized decline in market value totaling $111,000 less tax of $41,000, has been included as a separate component of shareholder's equity.

Salient/PMT's revenues are primarily from asset management and fiduciary fees based on a percentage of assets under administration. As a result, Salient/PMT is subject to equity price risk since its fees are directly affected by changes in the equity prices of the assets under its management. Similarly, Salient/PMT's fee income is subject to interest rate risk to the extent changes in interest rates affect the carrying value of assets under management. While these market risks are present, quantification remains difficult due to the number of other variables that affect Salient/PMT's fee income.

SMHG

In addition to the investment securities held by SMH and PMT, at December 31, 2003 the Company held securities recorded at a fair value of $10.8 million, including $4.1 million in marketable securities, $5.9 million representing investments in limited partnerships and $800,000 representing other not readily marketable securities.

Item 8. ***Financial Statements and Supplementary Data***

SANDERS MORRIS HARRIS GROUP INC. AND SUBSIDIARIES
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Independent Auditors' Report

The Board of Directors and Shareholders
Sanders Morris Harris Group Inc.:

We have audited the accompanying consolidated balance sheet of Sanders Morris Harris Group Inc. and subsidiaries (the Company) as of December 31, 2003 and 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2003. 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 consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sanders Morris Harris Group Inc. and subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the consolidated financial statements, the Company changed its method of accounting for goodwill in 2002.

/s/ KPMG LLP
KPMG LLP

Houston, Texas
March 11, 2004

SANDERS MORRIS HARRIS GROUP INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEET
As of December 31, 2003 and 2002
(in thousands, except share and per share amounts)

	December 31, 2003	December 31, 2002
ASSETS		
Cash and cash equivalents	$ 32,590	$ 34,890
Receivables, net of allowance of $400 and $295, respectively		
Broker-dealers	522	641
Customers	3,758	2,026
Related parties	6,100	4,489
Other	822	719
Deposits with clearing brokers	1,054	1,000
Securities owned	32,322	16,995
Securities available for sale	3,156	3,064
Furniture and equipment, net	4,227	4,021
Deferred tax asset	-	638
Other assets	3,004	1,167
Goodwill, net	49,447	47,673
Total assets	$ 137,002	$ 117,323
LIABILITIES AND SHAREHOLDERS' EQUITY		
Liabilities:		
Accounts payable and accrued liabilities	$ 20,060	$ 15,308
Deferred tax liability	647	-
Securities sold, not yet purchased	255	93
Other liabilities	144	190
Total liabilities	21,106	15,591
Commitments and contingencies		
Minority interests	1,043	421
Shareholders' equity:		
Preferred stock, $.10 par value; 10,000,000 shares authorized; no shares issued and oustanding	-	-
Common stock, $.01 par value; 100,000,000 shares authorized; 17,991,653 and 17,439,743 shares issued, respectively	180	174
Additional paid-in capital	113,781	109,959
Receivables for shares issued	(1,117)	(705)
Retained earnings (accumulated deficit)	6,015	(3,367)
Accumulated other comprehensive loss	(70)	(243)
Unearned compensation	(638)	(1,392)
Treasury stock at cost, 724,003 and 702,849 shares, respectively	(3,298)	(3,115)
Total shareholders' equity	114,853	101,311
Total liabilities and shareholders' equity	$ 137,002	$ 117,323

The accompanying notes are an integral part of these consolidated financial statements.

SANDERS MORRIS HARRIS GROUP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF OPERATIONS
For each of the three years in the period ended December 31, 2003

(in thousands, except share and per share amounts)

	2003	2002	2001
Revenues:			
Commissions	$ 51,219	$ 44,655	$ 24,532
Principal transactions	12,994	9,575	7,440
Investment banking	24,490	16,261	12,146
Fiduciary, custodial and advisory fees	10,368	7,507	6,403
Interest and dividends	2,546	1,877	2,403
Other income	2,317	2,502	1,727
Total revenues	103,934	82,377	54,651
Expenses:			
Employee compensation and benefits	64,362	52,118	36,053
Floor brokerage, exchange and clearance fees	5,517	4,255	3,190
Communications and data processing	5,664	4,427	3,705
Occupancy	5,760	4,512	3,794
Amortization of goodwill	-	-	2,172
Other general and administrative	9,678	8,219	6,643
Total expenses	90,981	73,531	55,557
Income (loss) from continuing operations before equity in income of limited partnerships, income taxes and minority interests	12,953	8,846	(906)
Equity in income of limited partnerships	4,305	2,352	3,740
Income before income taxes and minority interests	17,258	11,198	2,834
Provision for income taxes	(6,794)	(3,604)	(1,956)
Minority interests in net (income) loss of consolidated companies	(48)	(2,195)	188
Income from continuing operations	10,416	5,399	1,066
Loss on disposition of discontinued operations, net of tax	-	-	(121)
Net income	$ 10,416	$ 5,399	$ 945
Basic earnings (loss) per share:			
From continuing operations	$ 0.61	$ 0.32	$ 0.07
From discontinued operations	-	-	(0.01)
Basic earnings per share	$ 0.61	$ 0.32	$ 0.06
Diluted earnings (loss) per share:			
From continuing operations	$ 0.59	$ 0.32	$ 0.07
From discontinued operations	-	-	(0.01)
Diluted earnings per share	$ 0.59	$ 0.32	$ 0.06
Weighted average common shares outstanding			
Basic	17,095,626	16,621,698	15,828,654
Diluted	17,622,443	16,918,432	15,958,879

The accompanying notes are an integral part of these consolidated financial statements.

SANDERS MORRIS HARRIS GROUP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
For each of the three years in the period ended December 31, 2003
(in thousands except shares)

	Amounts						Shares		
	2003		2002		2001		2003	2002	2001
Common stock									
Balance, beginning of year	$ 174		$ 170		$ 161		17,439,743	17,009,402	16,100,512
Issuance for acquisitons	-		-		2		-	-	150,000
Employee benefit plan	6		4		7		551,910	430,341	758,890
Balance, end of year	180		174		170		17,991,653	17,439,743	17,009,402
Additional paid-in capital									
Balance, beginning of year	109,959		109,159		103,670				
Issuance for acquisitions	-		-		1,790				
Employee benefit plan	4,858		2,475		3,699				
Dividends ($0.12 per share in 2003; $0.10 per share in 2002)	(1,036)		(1,675)		-				
Balance, end of year	113,781		109,959		109,159				
Receivables for shares issued									
Balance, beginning of year	(705)		(541)		(558)				
Collections of receivables	-		48		510				
Issuance of restricted stock	(1,172)		(702)		(572)				
Amortization of unearned compensation	760		490		79				
Balance, end of year	(1,117)		(705)		(541)				
Retained earnings (accumulated deficit)									
Balance, beginning of year	(3,367)		(8,766)		(9,711)				
Dividends ($0.12 per share in 2003; $0.10 per share in 2002)	(1,034)		-		-				
Net income	10,416	10,416	5,399	5,399	945	945			
Balance, end of year	6,015	10,416	(3,367)	5,399	(8,766)	945			
Accumulated other comprehensive loss									
Balance, beginning of year	(243)		(57)		(452)				
Net change in unrealized appreciation (depreciation) on securities available for sale	275	275	(295)	(295)	594	594			
Income tax (provision) benefit on change	(102)	(102)	109	109	(199)	(199)			
Balance, end of year	(70)	173	(243)	(186)	(57)	395			
Comprehensive income		10,589		5,213		1,340			
Unearned compensation									
Balance, beginning of year	(1,392)		(1,097)		(1,204)				
Net issuance of restricted stock	(52)		(1,001)		107				
Amortization of unearned compensation	806		706		-				
Balance, end of year	(638)		(1,392)		(1,097)				
Treasury stock									
Balance, beginning of year	(3,115)		(2,585)		(3,184)		(702,849)	(597,038)	(802,124)
Issuance for acquisitions	-		-		2,416		-	-	600,000
Acquisition of treasury stock	(183)		(694)		(1,822)		(21,154)	(143,087)	(396,022)
Issuance of shares pursuant to employee benefit plans	-		164		5		-	37,276	1,108
Balance, end of year	(3,298)		(3,115)		(2,585)		(724,003)	(702,849)	(597,038)
Total shareholders' equity and common shares outstanding	**$ 114,853**		**$ 101,311**		**$ 96,283**		**17,267,650**	**16,736,894**	**16,412,364**

The accompanying notes are an integral part of these consolidated financial statements.

SANDERS MORRIS HARRIS GROUP INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
For each of the three years in the period ended December 31, 2003
(in thousands)

	2003	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 10,416	$ 5,399	$ 945
Adjustments to reconcile net income to net cash (used in) provided by operating activities:			
Loss (gain) on sale of securities available for sale	(18)	32	1,253
Depreciation	1,313	868	1,087
Deferred income taxes	1,177	307	892
Amortization of goodwill	-	-	2,172
Provision for bad debts	295	197	580
Compensation expense related to amortization of notes receivable and unearned compensation	1,566	1,196	186
Minority interests in net income (loss) of consolidated companies, net of distributions	48	295	(221)
Changes in assets and liabilities:			
(Increase) decrease in receivables	(3,226)	1,705	(421)
Increase in deposits with clearing brokers	(54)	(750)	-
Increase in securities owned	(15,327)	(4,842)	(2,478)
(Increase) decrease in other assets	(1,837)	(500)	14
Decrease (increase) in securities sold, not yet purchased	162	(29)	(469)
Decrease in other liabilities	(46)	(125)	(1,603)
Increase in accounts payable and accrued liabilities	4,033	6,275	1,329
Net cash (used in) provided by operating activities	(1,498)	10,028	3,266
CASH FLOWS FROM INVESTING ACTIVITIES:			
Capital expenditures	(1,361)	(2,965)	(651)
Acquisitions, net of cash acquired of $142; 0; and $30; respectively	(2,058)	-	(13)
Proceeds from sale of discontinued operations	-	-	205
Proceeds from sale of assets	3	-	41
Purchase of securities available for sale	(1,548)	(2,357)	(1,141)
Proceeds from sales and maturities of securities available for sale	1,749	657	2,935
Net cash (used in) provided by investing activities	(3,215)	(4,665)	1,376
CASH FLOWS FROM FINANCING ACTIVITIES:			
Purchase of treasury stock	(183)	(694)	(1,822)
Proceeds from shares issued	3,639	939	1,935
Collections on receivables for shares issued	-	48	510
Investment by minority interest	1,038	75	86
Payments to minority interests	(529)	-	-
Payments of cash dividends	(1,552)	(1,251)	-
Net cash provided by (used in) financing activities	2,413	(883)	709
Net (decrease) increase in cash and cash equivalents	(2,300)	4,480	5,351
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	34,890	30,410	25,059
CASH AND CASH EQUIVALENTS AT END OF YEAR	$ 32,590	$ 34,890	$ 30,410

The accompanying notes are an integral part of these consolidated financial statements.

SANDERS MORRIS HARRIS GROUP INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

Through its operating subsidiaries Sanders Morris Harris Inc. ("SMH"), Salient Capital Management ("Salient/PMT") and SMH Capital Advisors ("SMCA"), the Company provides a broad range of financial services, including institutional, prime and retail brokerage, investment banking, merchant banking, financial advisory, trust related services, investment management and financial planning. The Company serves a diverse group of institutional, corporate and individual clients.

The Company merged with and acquired its operating subsidiaries in 1999 through 2003. The acquisitions were accounted for using the purchase method and as a result current period results are not comparable to the prior periods.

Principles of Consolidation

The consolidated financial statements of the Company include the accounts of its subsidiaries. All material intercompany transactions and balances have been eliminated in consolidation.

Management's Estimates

The preparation of the consolidated 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 consolidated assets and liabilities and disclosure of contingent assets and liabilities at the dates of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Cash Equivalents

Highly liquid debt instruments with original maturities of three months or less when purchased are considered to be cash equivalents.

Securities Transactions

Marketable securities are carried at fair value based on quoted market prices. Not readily marketable securities are valued at fair value based on either internal valuation models or management's estimate of amounts that could be realized under current market conditions assuming an orderly liquidation over a reasonable period of time. Unrealized gains or losses from marking securities owned to market value are included in revenue under the caption principal transactions. Securities not readily marketable include securities (a) for which there is no market on a securities exchange or no independent publicly quoted market, (b) that cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933 or other applicable securities acts, or (c) that cannot be offered or sold because of other arrangements, restrictions or conditions applicable to the securities or to the Company. Proprietary transactions and the related income/expense are recorded on the trade date. Realized gains and losses from sales of securities are computed using the average cost method.

Investments in not readily marketable securities, marketable securities with insufficient trading volumes and restricted securities have been valued at their estimated fair value by the Company in the absence of readily ascertainable market values. These estimated values may differ significantly from the values that would have been used had a readily available market existed for these investments. Such differences could be material to the financial statements. At December 31, 2003 and 2002, the Company's investment portfolios included investments totaling $24.2 million and

$14.6 million, respectively, whose values had been estimated by the Company in the absence of readily ascertainable market values.

Securities Available for Sale

Securities available for sale include marketable equity securities and debt instruments owned by the Company's Salient/PMT subsidiary with maturities greater than three months when purchased. These securities are recorded at cost and are adjusted for unrealized holding gains and losses due to market fluctuations. These unrealized gains or losses, net of taxes, are recorded as other comprehensive income (loss) and are shown as a separate component of shareholders' equity. Gains and losses are recorded upon sale based on the specific identification method.

Furniture and Equipment

Furniture and equipment and leasehold improvements are carried at cost. Depreciation of office furniture and equipment is computed on a straight-line basis over a five to seven year period. Amortization of leasehold improvements is computed on a straight-line basis over the term of the lease. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation or amortization are removed from the accounts and any resulting gain or loss is reflected in income for the period. The cost of maintenance and repairs is charged to expense as incurred; significant renewals and betterments are capitalized.

Goodwill

Statement of Financial Accounting Standards (SFAS) No. 142 entitled *Goodwill and Other Intangible Assets* was issued in June 2001 and became effective for us on January 1, 2002. As a result, the Company ceased all goodwill amortization. Amortization expense was $2.2 million for the year ended December 31, 2001. SFAS No. 142 requires the Company to perform goodwill impairment tests on at least an annual basis. If impairment is determined to exist, the asset is written down to reflect the estimated future discounted cash flows expected to be generated by the underlying business. The Company determined that the fair values of the reporting units exceeded their carrying values; therefore goodwill does not appear to be impaired as of December 31, 2003. SFAS No. 142 requires SMHG to perform goodwill impairment tests on at least an annual basis. There can be no assurance that future goodwill impairment tests will not result in a charge to earnings. See Recently Issued Accounting Standards.

Resale and Repurchase Agreements

Transactions involving purchases of securities under agreements to resell (reverse repurchase agreements or reverse repos) or sales of securities under agreements to repurchase (repurchase agreements or repos) are accounted for as collateralized financings. It is the policy of the Company to obtain the possession of collateral with a market value equal to or in excess of the principal amount loaned under resale agreements. Collateral is valued daily, and the Company may require counterparties to deposit additional collateral or return collateral pledged when appropriate.

Stock-based Compensation

SFAS No. 148, *Accounting for Stock-Based Compensation – Transition and Disclosure,* was issued in December 2002. SFAS No. 148 amends SFAS No. 123, *Accounting for Stock-Based Compensation,* to provide alternative methods for transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company has adopted the disclosure provisions included in SAFS No. 148 in the notes to the consolidated financial statements contained herein.

The Company applies the intrinsic value-based method of accounting prescribed by Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* and related interpretations including FASB Interpretation No. 44, *Accounting for Certain Transactions involving Stock Compensation an Interpretation of APB Opinion No. 25,* issued in March 2000, to account for its fixed plan stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price.

The following table illustrates the effect on net income as if the Company had applied the fair value recognition provisions of SFAS No. 123 as amended by SFAS No. 148:

	Year Ended December 31,		
	2003	**2002**	**2001**
	(in thousands, except per share amounts)		
Net income, as reported	$ 10,416	$ 5,399	$ 945
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(472)	(767)	(931)
Pro forma net income	$ 9,944	$ 4,632	$ 14
Earnings per share:			
Basic-as reported	$ 0.61	$ 0.32	$ 0.06
Basic-pro forma	$ 0.58	$ 0.28	$ -
Diluted-as reported	$ 0.59	$ 0.32	$ 0.06
Diluted-pro forma	$ 0.56	$ 0.27	$ -

Income Taxes

The Company utilizes the asset and liability method for deferred income taxes. This method requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events recognized in the Company's financial statements or tax returns. All expected future events other than changes in the law or tax rates, are considered in estimating future tax consequences.

The provision for income taxes includes federal, state, and local income taxes currently payable and those deferred because of temporary differences between the financial statements and tax bases of assets and liabilities.

Commissions

Commissions and related clearing expenses are recorded on the trade date as securities transactions occur.

Investment Banking

Investment banking revenues include gains, losses, and fees, net of syndicate expenses, arising from securities offerings in which the Company acts as an underwriter or agent. Investment banking revenues also include fees earned from providing merger and acquisition and financial restructuring advisory services. Investment banking management fees are recorded on offering date, sales concessions on settlement date, and underwriting fees at the time the underwriting is completed and the income is realized or realizable and earned. Other investment banking fees are recognized when the services have been performed.

Fiduciary, Custodial and Advisory Fees

Fiduciary, custodial and advisory fees are recorded based on a percentage of each individual account's market value on the last day of the month.

Investments in Limited Partnerships

Investments in limited partnerships are accounted for using the equity method, which approximates fair value, and consist of Environmental Opportunities Fund, L.P., Sanders Opportunity Fund, L.P., Sanders Opportunity Fund (Institutional), L.P., Environmental Opportunities Fund II, L.P., Environmental Opportunities Fund II (Institutional), L.P., Corporate Opportunities Fund, L.P., Corporate Opportunities Fund (Institutional), L.P., Life Sciences Opportunity Fund, L.P., Life Sciences Opportunity Fund (Institutional), L.P., Tactical Opportunities High Yield Fund, L.P., Life Sciences Opportunity Fund II, L.P., Life Sciences Opportunity Fund (Institutional) II, L.P. and 2003 Houston Energy Partners, L.P.

Fair Values of Financial Instruments

The fair values of cash and cash equivalents, receivables, accounts payable and accrued liabilities, and payable to broker-dealers, approximate cost due to the short period of time to maturity. Securities owned, securities available for sale, and securities sold short, not yet purchased are carried at their fair values.

Reclassifications

Certain reclassifications have been made to the 2002 and 2001 consolidated financial statements to conform them with the 2003 presentation. Such reclassifications had no effect on the results of operations or shareholders' equity as previously reported.

Recently Issued Accounting Standards

SFAS No. 141 entitled *Business Combinations* was issued in June 2001 and became effective July 1, 2001. SFAS No. 141 requires that all business combinations be accounted for using the purchase method of accounting, which requires that acquisitions be recorded at fair value as of the date of acquisition. SFAS No. 142 entitled *Goodwill and Other Intangible Assets* was also issued in June 2001, in concert with SFAS No. 141. SFAS No. 142 became effective for us on January 1, 2002. As a result, the Company ceased all goodwill amortization.

The following table presents the impact of SFAS No. 142 on income from continuing operations, and earnings per share from continuing operations had the standard been in effect for the year ended December 31, 2001.

		Year Ended December 31,	
	2003	2002	2001
	(in thousands, except per share amounts)		
Reported income from continuing operations	$ 10,416	$ 5,399	$ 1,066
Adjustment:			
Amortization of goodwill	-	-	2,172
Adjusted income from continuing operations	$ 10,416	$ 5,399	$ 3,238
Basic earnings per share from continuing operations:			
Reported earnings per share	$ 0.61	$ 0.32	$ 0.07
Adjusted earnings per share	$ 0.61	$ 0.32	$ 0.20
Diluted earnings per share from continuing operations:			
Reported earnings per share	$ 0.59	$ 0.32	$ 0.07
Adjusted earnings per share	$ 0.59	$ 0.32	$ 0.20

In December 2003, the FASB issued FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities,* which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. FIN 46R replaces FASB Interpretation No. 46, *Consolidation of Variable Interest Entities,* which was issued in January 2003. The Company will be required to apply FIN 46R to variable interests in VIEs in its consolidated financial statements for the quarter ending March 31, 2004. For any VIEs that must be consolidated under FIN 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date FIN 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE. The Company has identified one entity that would require consolidation under this Interpretation. The Company expects consolidation of this entity to increase the Company's assets and liabilities by approximately $100,000 and have an insignificant effect on the other basic consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.* SFAS No. 150 requires certain financial instruments that have characteristics of both liabilities and equity to be classified as a liability on the consolidated statement of financial condition. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first fiscal period beginning after December 15, 2003. The Company does not have any financial instruments affected by the adoption of SFAS No. 150.

2. ACQUISITIONS

In January 2002, the former institutional equity unit of Sutro & Co. (the "New Institutional Group") joined the Company. The New Institutional Group complemented Sanders Morris Harris' existing institutional division by increasing its sales and trading base and by adding equity research in areas not previously covered. As an inducement for the principal of the Juda Group to join Sanders Morris Harris, we issued an aggregate of 357,909 shares of SMHG common stock under our 1998 Incentive Plan at a total purchase price that represented effectively a 33 1/3% discount to the then closing sales price of our common stock on the Nasdaq National Market. Approximately one-third of these shares, or 107,223 shares, vest over a three year period, with 50% of these shares vesting after one year and 25% of these shares vesting after the second and third years.

In April 2002, the investment professionals of Douglas-Noyes joined the Company. Douglas-Noyes provides asset management services with a focus on portfolios having a concentration on large cap equities with a potential for growth.

On May 2, 2003, the Company acquired a 50% ownership interest in the Salient companies. Additionally, the Company acquired a 23.15% profits interest in the advisor to The Endowment Fund, a related entity. The former owners of Salient and The Endowment Fund received cash payments totaling $1.75 million and may later receive an additional $250,000 cash payment and up to 1,200,000 common shares. The Salient companies and Pinnacle Management & Trust Company ("PMT") were contributed to Salient Capital Management ("Salient/PMT"), which entity's Class A limited partner units are jointly owned by the Company and the former owners of Salient. Additionally, the Company received Class B limited partner units of Salient/PMT, which in the event of a liquidation or sale of Salient/PMT entitle the Company to first receive proceeds equal to the net asset value of PMT as of May 2, 2003, (approximately $4.4 million) with the remaining proceeds to be divided equally among the owners of the Class A units. The Salient companies provide investment advisory services to individuals and institutions. The Endowment Fund is a diversified fund of funds using hedge fund managers that specialize in a variety of investment approaches. The acquisitions were accounted for as a purchase, and accordingly, the financial information of the Salient companies and the advisor to The Endowment Fund has been included in the Company's consolidated financial statements from May 2, 2003. The purchase price of approximately $1.8 million exceeded the fair market value of identifiable net assets by approximately $1.7 million, which has been recorded as goodwill. The Company uses the consolidation method to account for its investment in Salient/PMT.

On December 2, 2003, the Company acquired the Tulsa, Oklahoma branch office of U.S. Bankcorp Piper Jaffray Inc. The Tulsa office provides retail brokerage services to its clients. The former owner of the Tulsa office received $377,000 in cash. The acquisition was accounted for as a purchase and, accordingly, the financial information of the Tulsa office has been included in the Company's consolidated financial statements from December 2, 2003. The purchase price of approximately $377,000 exceeded the fair value of identifiable net assets acquired by approximately $17,000, which has been recorded as goodwill.

3. ALLOWANCE FOR DOUBTFUL ACCOUNTS

The following table sets forth pertinent information regarding the allowance for doubtful accounts at December 31, 2003, 2002 and 2001 (in thousands):

Balance at December 31, 2000	$ 615
Additions charged to cost and expenses	580
Charge off of receivables	(910)
Balance at December 31, 2001	285
Additions charged to cost and expenses	197
Charge off of receivables	(187)
Balance at December 31, 2002	295
Additions charged to cost and expenses	295
Charge off of receivables	(190)
Balance at December 31, 2003	$ 400

4. SECURITIES OWNED AND SECURITIES SOLD, NOT YET PURCHASED

Securities owned and securities sold, not yet purchased at December 31, 20003 and 2002 were as follows:

	2003		2002	
	Owned	Sold, Not Yet Purchased	Owned	Sold, Not Yet Purchased
	(in thousands)		(in thousands)	
Marketable:				
U. S. Government and agency	$ 4,103	$ -	$ -	$ -
Corporate stocks	435	255	764	93
Corporate bonds and commercial paper	3,536	-	1,639	-
	8,074	255	2,403	93
Not readily marketable:				
Partnerships	16,523	-	9,663	-
Corporate stocks and warrants	7,725	-	4,929	-
	$ 32,322	$ 255	$ 16,995	$ 93

Securities not readily marketable include investment securities (a) for which there is no market on a securities exchange or no independent publicly quoted market, (b) that cannot be publicly offered or sold unless registration has been effected under the Securities Act of 1933, or (c) that cannot be offered or sold because of other arrangements, restrictions, or conditions applicable to the securities or to the Company. Not readily marketable securities consist of investments in limited partnerships, equities, options and warrants. The investments in limited partnerships are accounted for using the equity method, which approximates fair value, and principally consist of Environmental Opportunities Fund, L.P., Environmental Opportunities Fund II, L.P., Environmental Opportunities Fund II (Institutional), L.P., Corporate Opportunities Fund, L.P., Corporate Opportunities Fund (Institutional), L.P., Sanders Opportunity Fund, L.P., Sanders Opportunity Fund (Institutional), L.P., Life Sciences Opportunity Fund, L.P., Life Sciences Opportunity Fund (Institutional), L.P., Tactical Opportunities High Yield Fund, L.P., Life Sciences Opportunity Fund II, L.P., Life Sciences Opportunity Fund (Institutional) II, L.P. and 2003 Houston Energy Partners L.P.

The Company has issued a letter of credit in the amount of $1.5 million to the owner of one of the offices that we lease to secure payment of our lease obligation for that facility. The letter of credit is secured by securities owned in the amount of $1.5 million.

A summary of the results of operations and net assets of the limited partnerships is as follows for the years ended December 31, 2003 and 2002:

	2003	2002
	(in thousands)	
Net investment loss	$ (98)	$ (312)
Unrealized gain on investments	6,388	8,303
Realized gain on investments	24,537	10,228
Increase in partners' capital resulting from operations	$ 30,827	$ 18,219
Total assets	$ 178,736	$ 134,890
Total liabilities	5,938	2,680
Partners' capital	$ 172,798	$ 132,210

5. SECURITIES AVAILABLE FOR SALE

Securities available for sale at December 31, 2003 and 2002 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
2003:				
U.S. Government and agency obligations	$ 1,296	$ 13	$ (2)	$ 1,307
Marketable equity securities	1,972	74	(197)	1,849
Total	$ 3,268	$ 87	$ (199)	$ 3,156
2002:				
U.S. Government and agency obligations	$ 1,309	$ 17	$ (4)	$ 1,322
Marketable equity securities	2,141	11	(410)	1,742
Total	$ 3,450	$ 28	$ (414)	$ 3,064

The amortized cost and fair value of debt securities available for sale at December 31, 2003 were as follows:

	Amortized Cost	Fair Value
	(in thousands)	
Due after 1 year through 5 years	$ 1,001	$ 1,006
Due after 5 years through 10 years	295	301
	$ 1,296	$ 1,307

The Company's available for sale portfolio is comprised of U.S. government agency obligations and large cap equity securities. Two U.S. government agency obligations and 17 equity securities have unrealized losses as of December 31, 2003. The two U.S. government agency obligations have been in continuous unrealized-loss positions for less than 12 months. Of the 17 equity securities, 12 have been in continuous unrealized-loss positions for more than 12 months, and five have been in continuous unrealized-loss positions for less than 12 months.

Securities available for sale in an unrealized loss position were as follows on December 31, 2003 (in thousands):

	Less than 12 months		12 months or longer		Total	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
U.S. government and agency obligations	$ 499	$ (2)	$ -	$ -	$ 499	$ (2)
Marketable equity securities	214	(22)	1,036	(175)	1,250	(197)
Total temporarily impaired securities	$ 713	$ (24)	$ 1,036	$ (175)	$ 1,749	$ (199)

Management evaluates securities available for sale to determine if a decline in value is other than temporary. Such evaluation considers the length of time and the extent to which market value has been less than cost, the financial condition and near-term prospects of the issuer, and the intent and ability of the Partnership to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value. Management believes the unrealized losses are temporary at December 31, 2003. However, a write-down accounted for as a realized loss may be necessary in the future.

Gross gains on sales of securities available for sale were approximately $47,000 for the year ended December 31, 2003, and approximately $25,000 for the year ended December 31, 2002. Gross losses on sales of securities available for sale were approximately $29,000 for the year ended December 31, 2003, and approximately $57,000 for the year ended December 31, 2002. Such gains and losses are included in revenue under the caption Principal transactions.

The Company has pledged securities valued at $250,000 to the bank commissioner of the state of Oklahoma to secure its performance of fiduciary duties for trust activities conducted in that state.

6. RECEIVABLE FROM BROKER-DEALERS

Amounts receivable from broker-dealers at December 31, 2003 and 2002 were as follows:

	2003	2002
	(in thousands)	
Receivable from clearing organizations	$ 522	$ 641

7. DEPOSITS WITH CLEARING BROKERS AND DEALERS

Under its clearing agreements, SMH is required to maintain a certain level of cash or securities on deposit with clearing brokers and dealers. Should the clearing brokers and dealers suffer a loss due to the failure of a customer of the Company to complete a transaction, the Company is required to indemnify the clearing brokers and dealers. The Company had $1.1 million and $1 million on deposit as of December 31, 2003 and 2002, respectively, with clearing brokers and dealers to meet this requirement.

8. FURNITURE AND EQUIPMENT

Furniture and equipment at December 31, 2003 and 2002 was as follows:

	Estimated useful life in years	December 31, 2003	December 31, 2002
		(in thousands)	
Equipment	5	$ 3,726	$ 3,187
Furniture and fixtures	7	1,971	1,571
Leasehold improvements	5 to 11	1,865	1,458
Accumulated depreciation and amortization		(3,335)	(2,195)
Furniture and equipment, net		$ 4,227	$ 4,021

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at December 31, 2003 and 2002 were as follows:

	December 31,	
	2003	2002
	(in thousands)	
Accounts payable	$ 3,213	$ 2,352
Compensation	16,814	11,853
Other	33	1,103
Total accounts payable and accrued liabilities	$ 20,060	$ 15,308

10. INCOME TAXES

The components of the income tax provision (benefit) for the years ended December 31, 2003, 2002, and 2001 were as follows:

	Year Ended December 31,		
	2003	2002	2001
		(in thousands)	
Continuing operations:			
Current	$ 5,617	$ 3,297	$ 1,064
Deferred	1,177	307	892
Total continuing operations	6,794	3,604	1,956
Discontinued operations	-	-	(95)
Income tax provision	$ 6,794	$ 3,604	$ 1,861

The difference between the effective tax rate reflected in the income tax provision for continuing operations, including minority interests, and the statutory federal rate is analyzed as follows:

	Year Ended December 31,		
	2003	2002	2001
		(in thousands)	
Tax computed using the statutory rate	$ 5,851	$ 3,061	$ 1,028
Nondeductible amortization of goodwill	-	-	804
State income taxes	861	450	91
Other	82	93	33
Total	$ 6,794	$ 3,604	$ 1,956

The effective tax rates for continuing operations for the years ended December 31, 2003, 2002, and 2001 were 39.5%, 40.0%, and 64.7%, respectively.

The components of the deferred income tax assets and liabilities were as follows:

	2003	2002
	(in thousands)	
Deferred income tax assets:		
Accumulated depreciation	$ -	$ 289
Accrued liabilities	164	164
Allowance for doubtful accounts	156	115
Partnership income	78	202
Deferred compensation	1,422	1,196
Unrealized loss on securities available for sale	43	151
Total deferred tax assets	1,863	2,117
Deferred income tax liabilities:		
Accumulated depreciation	(85)	-
Unrealized gains on securities	(2,265)	(1,241)
Other	(160)	(238)
Total deferred tax liabilities	(2,510)	(1,479)
Net deferred tax (liability) asset	$ (647)	$ 638

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences.

11. EMPLOYEE BENEFIT PLANS

During 2002, the Company's shareholders approved an amendment to the Company's 1998 Incentive Plan to increase the number of shares of its common stock available for incentive awards or incentive stock options from the greater of 1,100,000 shares or 15% of the total number of shares of common stock outstanding to the greater of 4,000,000 shares or 25% of the total number of shares of common stock outstanding.

Substantially all employees are eligible to participate in the Sanders Morris Harris Group Inc. 401(k) defined contribution plan. The Company made no contributions to this plan in 2003, 2002, and 2001.

A. Stock Options

The Incentive Plan provides for the issuance to eligible employees of, among other things, incentive and non-qualified stock options, which may expire as much as 10 years from the date of grant. The outstanding options vest over varying periods and have an exercise price equal to the closing price of the Company's stock on the date of the grant.

The following table sets forth pertinent information regarding stock option transactions for each of the three years in the period ended December 31, 2003:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Fair Value
Outstanding at December 31, 2000	1,010,499	$ 4.89	
Granted	444,230	5.11	$ 4.45
Cancelled/Forfeited	(113,255)	4.68	
Outstanding at December 31, 2001	1,341,474	4.97	
Granted	210,000	5.69	$ 2.91
Cancelled/Forfeited	(63,000)	5.19	
Exercised	(12,250)	4.44	
Oustanding at December 31, 2002	1,476,224	5.07	
Granted	30,000	8.12	$ 1.50
Cancelled/Forfeited	(60,750)	5.47	
Exercised	(378,114)	4.71	
Oustanding at December 31, 2003	1,067,360	$ 5.25	
Options exercisable at December 31, 2001	814,862	$ 5.07	
Options exercisable at December 31, 2002	1,156,974	$ 5.08	
Options exercisable at December 31, 2003	960,610	$ 5.25	
Options available for grant at December 31, 2001	724,400		
Options available for grant at December 31, 2002	1,500,830		
Options available for grant at December 31, 2003	1,522,392		

The following tables summarize information related to stock options outstanding and exercisable at December 31, 2003:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/03	Wgtd. Avg. Remaining Contr. Life	Wgtd. Avg. Exercise Price	Number Exercisable at 12/31/2003	Wgtd. Avg. Exercise Price
$4.44-$6.04	987,360	5.7	$ 4.92	880,610	$ 4.88
$7.91-$10.00	80,000	4.0	9.29	80,000	9.29
$4.44-$10.00	1,067,360	5.6	$ 5.25	960,610	$ 5.25

The fair value of each stock option granted is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: dividend yield of 1.29% to 2.06%; risk-free interest rate ranging from 1.69% to 4.43%; the expected life of options is seven to 10 years; and volatility ranging from 31.43% to 108.7% for the grants.

B. Restricted and Capital Incentive Plan ("CIP")

Effective January 1, 2001, the Company adopted the CIP under its Incentive Plan in which eligible employees and consultants may purchase, in lieu of salary, commission or bonus, shares of the Company's restricted common stock at a price equal to 66.6% of the 20-day average of the closing sales prices for a share of the Company's common stock, ending on the day prior to the date the shares are issued.

All shares issued are valued at the closing price on the date the shares are issued. Consideration paid through the deferral of salaries, commissions, or discretionary bonuses is recorded as compensation expense on the date the shares are issued. The difference between the value of the shares issued and the consideration paid is recorded as unearned compensation and is shown as a separate component of shareholders' equity. Additionally, shares are issued under the CIP in conjunction with notes receivable, which are amortized to compensation expense over the three-year vesting periods.

The following summarizes certain information related to the CIP for the years ended December 31, 2003 and 2002:

	Year Ended December 31,	
	2003	2002
	(in thousands, except shares)	
Number of shares issued	126,690	418,152
Value of shares issued	$ 1,154	$ 2,393
Additions to unearned compensation	52	1,001
Additions to notes receivable	1,093	702
Amortization of unearned compensation	806	706
Amortization of notes receivable	760	490

12. PREFERRED STOCK

The Company is authorized to issue 10,000,000 shares of Preferred Stock, par value $.10 per share. Shares of Preferred Stock may be issued from time to time by the Board of Directors, without action by the shareholders, in one or more series with such designations, preferences and special rights and qualifications, limitations, and restrictions as may be designated by the Board of Directors prior to the issuance of such series. No shares of Preferred Stock have been issued as of December 31, 2003.

13. TREASURY STOCK

The Company repurchases its common stock from time to time primarily to offset the dilutive effect of its employee benefit plan. Such repurchases are accounted for using the cost method. The Company reacquired 21,154 and 143,087 shares of its common stock, for an aggregate purchase price of $183,000 and $694,000 during the years ended December 31, 2003 and 2002, respectively.

14. EARNINGS PER COMMON SHARE

Basic and diluted earnings per-share computations for the periods indicated were as follows:

	Year Ended December 31, 2003	2002	2001
	(in thousands, except share and per share amounts)		
Computation of basic earnings per common share:			
Net income	$ 10,416	$ 5,399	$ 945
Weighted average common shares outstanding	17,095,626	16,621,698	15,828,654
Basic earnings per common share	$ 0.61	$ 0.32	$ 0.06
Computation of diluted earnings per common share:			
Net income	$ 10,416	$ 5,399	$ 945
Weighted average number of common shares outstanding	17,095,626	16,621,698	15,828,654
Common shares issuable under stock option plan	1,017,359	1,426,223	921,179
Less shares assumed repurchased with proceeds	(490,542)	(1,129,489)	(790,954)
Weighted average common shares outstanding	17,622,443	16,918,432	15,958,879
Diluted earnings per common share	$ 0.59	$ 0.32	$ 0.06

Outstanding stock options (50,000 at December 31, 2003; 50,000 at December 31, 2002; and 420,294 at December 31, 2001 have not been included in diluted earnings per common share because to do so would have been antidilutive for the periods presented.

15. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company enters into underwriting commitments. There were no firm underwriting commitments open at December 31, 2003.

Total rental expense for operating leases for the years indicated was: for 2003, approximately $3.5 million; for 2002, approximately $2.9 million; and for 2001, approximately $2.1 million. The Company and its subsidiaries have obligations under operating leases that expire by 2014 with initial noncancelable terms in excess of one year. Aggregate annual rentals for office space and computer and office equipment are as follows (in thousands):

2004	$ 3,018
2005	3,577
2006	3,715
2007	3,307
2008	2,428
Thereafter	12,226
Total minimum rental payments	$ 28,271

The Company is a party to various legal proceedings that are of an ordinary or routine nature incidental to our operations. The Company believes it has adequately reserved for such litigation matters and that they will not have a material adverse effect on consolidated financial condition, results of operations or cash flows.

The Company has uncommitted financing arrangements with our clearing brokers that finance our customer accounts, certain broker-dealer balances and firm trading positions. Although these customer accounts and broker-dealer balances are not reflected on the consolidated balance sheets for financial accounting reporting purposes, the Company has generally agreed to indemnify these clearing brokers for losses they may sustain in connection with the accounts and therefore, retains risk on these accounts. The Company is required to maintain certain cash or securities on deposit with our clearing brokers.

16. CONCENTRATIONS OF CREDIT RISK

Financial investments that potentially subject the Company to concentrations of credit risk primarily consist of securities available for sale, securities owned and all receivables. Risks and uncertainties associated with financial investments include credit exposure, interest rate volatility, regulatory changes, and changes in market values of equity securities. Future changes in market trends and conditions may occur that could cause actual results to differ materially from the estimates used in preparing the accompanying consolidated financial statements.

The Company and its subsidiaries are engaged in various trading and brokerage activities with counterparties that primarily include broker-dealers, banks and other financial institutions. If counterparties do not fulfill their obligations, the Company may be exposed to risk. The risk of default depends on the creditworthiness of the counterparty or issuer of the instrument. It is the Company's policy to review, as necessary, the credit standing of each counterparty.

17. NET CAPITAL REQUIREMENTS OF SUBSIDIARIES

SMH is subject to the Securities and Exchange Commission Uniform Net Capital Rule (SEC rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1 (and the rule of the "applicable" exchange also provides that equity capital may not be withdrawn or cash dividends paid if the resulting net capital ratio would exceed 10 to 1). At December 31, 2003, SMH had net capital of $16.6 million, which was $15.5 million in excess of its required net capital of $1.1 million. PMT is required by the Texas Department of Banking to maintain minimum capital of $1.5 million. At December 31, 2003, PMT had net capital of $4.7 million.

18. BUSINESS SEGMENT INFORMATION

The Company's continuing businesses operate in two reportable business segments. The Company's investment banking and brokerage segment includes the operations of SMH. SMH is an investment banking and brokerage services firm whose activities primarily include securities underwriting, private placements, and institutional, prime and retail brokerage services. The Company's investment management segment includes the operations of Salient/PMT and SMH Capital Advisors. Salient/PMT provides financial advisory and trust services including investment management, estate settlement, and retirement planning. SMH Capital Advisors provides investment management and financial planning services to individuals and institutions. The following summarizes certain financial information of each reportable segment:

(in thousands)	Investment Banking and Brokerage	Investment Management	Corporate and Other	Consolidated Total
Year Ended December 31, 2003				
Revenues	$ 93,950	$ 8,216	$ 1,768	$ 103,934
Other expenses	(81,493)	(6,471)	(3,017)	(90,981)
Income (loss) before equity in income (loss) of limited partnerships, income taxes and minority interests	12,457	1,745	(1,249)	12,953
Equity in income (loss) of limited partnerships	4,478	-	(173)	4,305
Income (loss) before income taxes and minority interests	$ 16,935	$ 1,745	$ (1,422)	$ 17,258
Year Ended December 31, 2002				
Revenues	$ 76,354	$ 5,825	$ 198	$ 82,377
Other expenses	(66,140)	(5,010)	(2,381)	(73,531)
Income (loss) before equity in income of limited partnerships, income taxes and minority interests	10,214	815	(2,183)	8,846
Equity in income of limited partnerships	2,260	-	92	2,352
Income (loss) before income taxes and minority interests	$ 12,474	$ 815	$ (2,091)	$ 11,198
Year Ended December 31, 2001				
Revenues	$ 51,599	$ 3,298	$ (246)	$ 54,651
Amortization of goodwill	-	-	(2,172)	(2,172)
Other expenses	(47,074)	(3,867)	(2,444)	(53,385)
Income (loss) before equity in income of limited partnerships, income taxes and minority interests	4,525	(569)	(4,862)	(906)
Equity in income of limited partnerships	3,740	-	-	3,740
Income (loss) before income taxes and minority interests	$ 8,265	$ (569)	$ (4,862)	$ 2,834

(in thousands)	Investment Banking and Brokerage	Investment Management	Corporate and Other	Consolidated Total
Total assets as of December 31, 2003	$ 96,805	$ 8,600	$ 31,597	$ 137,002
Total assets as of December 31, 2002	$ 80,614	$ 6,701	$ 30,008	$ 117,323

19. SUPPLEMENTAL CASH FLOW INFORMATION

	2003	2002	2001
		(in thousands)	
Cash paid for interest	$ 6	$ 6	$ 7
Cash paid for income taxes	5,380	3,407	1,173
Cash received from income tax refunds	-	292	41
Non-cash investing and financing activities:			
Acquisitions:			
Cash	142	-	30
Receivables	396	-	-
Other assets	160	-	456
Accounts payable and accrued liabilities	(206)	-	(409)
Issuance of common and treasury stock	-	-	(4,208)

20. RELATED PARTIES

SMH earned fees (for 2003, $1.7 million; for 2002, $1.2 million; and for 2001, $528,000) through the sale of annuity products from HWG Insurance Agency, Inc. The sole shareholder of HWG Insurance Agency is an employee of SMH.

The Company, through its wholly owned venture capital investment company subsidiary, SMHG Capital Inc., owns an investment in Brava Therapeutics, Inc. ("Brava"), formerly named BioCyte Therapeutics, Inc., which is accounted for at fair value. The Company's president has an investment in Brava and serves on its board of directors. Another employee of the Company has an investment in Brava, serves as the president of Brava, and also serves on its board of directors. Certain other of the Company's employees also perform services on behalf of Brava. The Company allocates a portion of employee compensation costs of certain of these employees to Brava. Such allocations aggregated $132,000, $133,000, and $245,000, during 2003, 2002, and 2001, respectively. The Company had outstanding receivables from Brava of $18,000 and $189,000 at December 31, 2003 and 2002, respectively, related primarily to unpaid employee compensation cost allocations.

The Company owns controlling interests in several limited liability companies that act as the general partners in several limited partnerships (the "Partnerships"). The Partnerships pay management fees to the general partners. Certain officers of SMH serve on the boards of directors of entities in which the Partnerships invest. In addition, SMH has served, and may in the future serve, as the placement agent advisor, offering manager or underwriter for companies in which the Partnerships invest.

In connection with the January 1999 combination, certain employees of the financial services firms exercised warrants and options for the purchase of shares in their respective companies, which were then exchanged for shares of the Company. To exercise the warrants and options, the employees borrowed the aggregate exercise price from the Company. The loans were evidenced by recourse promissory notes and were secured by pledges of the SMHG common shares acquired as part of the exchange. Interest accrued on the unpaid principal balance at the federal rate published by the Internal Revenue Service for obligations of comparable maturity. During 2000, 2001 and 2002, the Company exchanged a portion of the notes receivable from employees for the Company's common shares that were pledged to secure the notes.

During 2001, the Company formed PTC – Houston Management, L.P. ("PTC") to secure financing for a new proton beam therapy cancer treatment center to be constructed in Houston. A director of SMHG and his family are the principal owners of an entity that is a fifty percent owner of PTC. Net operating income recognized by PTC totaled $414,000 during 2003 and $4.4 million during 2002. Fifty percent of the net operating income, or $207,000 in 2003 and $2.2 million in 2002, was attributable to each of SMHG and the director-owned entity. During 2001, net operating losses recognized by PTC totaled $116,000, 50% of which, or $58,000, was attributable to each of SMHG and the director-owned entity.

21. UNAUDITED QUARTERLY FINANCIAL INFORMATION

	Three Months Ended (in thousands, except share and per share amounts)			
2003:	March 31, 2003	June 30, 2003	Sept. 30, 2003	Dec. 31, 2003
Total revenues	$ 20,932	$ 27,619	$ 24,175	$ 31,208
Net income	$ 1,189	$ 3,395	$ 2,303	$ 3,528
Basic earnings per share	$ 0.07	$ 0.20	$ 0.13	$ 0.20
Diluted earnings per share	$ 0.07	$ 0.19	$ 0.13	$ 0.20
Weighted average common shares outstanding - diluted	17,394,518	17,641,257	17,669,969	17,736,445
2002:	March 31, 2002	June 30, 2002	Sept. 30, 2002	Dec. 31, 2002
Total revenues	$ 20,823	$ 19,209	$ 17,419	$ 24,926
Net income (loss)	$ 1,969	$ 1,100	$ (166)	$ 2,494
Basic earnings (loss) per share	$ 0.12	$ 0.07	$ (0.01)	$ 0.14
Diluted earnings (loss) per share	$ 0.12	$ 0.07	$ (0.01)	$ 0.14
Weighted average common shares outstanding - diluted	16,604,213	16,886,188	16,674,678	17,225,988

22. SUBSEQUENT EVENTS

On February 18, 2004, the Company announced that its board of directors declared a cash dividend for the first quarter of 2004, in the amount of $0.0375 per share of common stock. The cash dividend will be payable on April 15, 2004 to holders of record as of the close of business on April 1, 2004.

Item 9. *Changes in and Disagreements with Accountants on Accounting and Financial Disclosure*

The Company had no disagreements on accounting or financial disclosure matters with its independent accountants to report under this Item 9.

Item 9A. *Controls and Procedures*

Our management, including our Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-14(c) promulgated under the Exchange Act) as of the end of the fiscal period covered by this report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures are effective for timely gathering, analyzing and disclosing the information we are required to disclose in our reports filed under the Exchange Act. There have been no significant changes made in our internal controls over financial reporting or in other factors that could significantly affect our internal controls over financial reporting subsequent to the date of this evaluation.

PART III.

Item 10. ***Directors and Executive Officers of the Registrant***

The information required in response to this Item 10 is incorporated herein by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year covered by this report.

Item 11. ***Executive Compensation***

The information required in response to this Item 11 is incorporated herein by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year covered by this report.

Item 12. ***Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters***

The information required in response to this Item 12 is incorporated herein by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year covered by this report.

Item 13. ***Certain Relationships and Related Transactions***

The information required in response to this Item 13 is incorporated herein by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year covered by this report.

Item 14. ***Principal Accountant Fees and Services***

The information required in response to this Item 14 is incorporated herein by reference to the Company's definitive Proxy Statement to be filed with the Securities and Exchange Commission pursuant to Regulation 14A, not later than 120 days after the end of the fiscal year covered by this report.

PART IV.

Item 15. ***Exhibits, Financial Statement Schedules and Reports on Form 8-K***

(a) 1. Financial Statements

The following financial statements of the Company and Independent Auditors' Report are included under Part II Item 8 of this Form 10-K.

2. Financial Statement Schedules

All schedules for which provision is made in the applicable accounting regulations of the Securities and Exchange Commission are not required under the related instructions, are inapplicable, or the required information is included elsewhere in the consolidated financial statements.

3. Exhibits

The exhibits filed in response to Item 601 of Regulation S-K are listed in the Index to Exhibits contained elsewhere herein.

(b) Reports on Form 8-K

On November 12, 2003, the Company filed a current report on Form 8-K relating to (i) the declaration by its board of directors of a cash dividend in the amount of $0.03 per share of common stock, and (ii) the Company's earnings report for the quarter ended September 30, 2003.

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, on March 12, 2004.

SANDERS MORRIS HARRIS GROUP INC.

By: /s/ BEN T. MORRIS
Chief Executive Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities indicated and on the 12th day of March 2004.

Signature	Title
/s/ BEN T. MORRIS **Ben T. Morris**	Chief Executive Officer and Director (Principal Executive Officer)
/s/ ROBERT E. GARRISON II **Robert E. Garrison II**	President and Director
/s/ GEORGE L. BALL **George L. Ball**	Chairman of the Board
/s/ DON A. SANDERS **Don A. Sanders**	Vice Chairman
/s/ RICHARD E. BEAN **Richard E. Bean**	Director
/s/ DONALD R. CAMPBELL **Donald R. Campbell**	Director
/s/ TITUS H. HARRIS, JR. **Titus H. Harris, Jr.**	Director
/s/ NOLAN RYAN **Nolan Ryan**	Director
/s/ JOHN H. STYLES **John H. Styles**	Director
/s/ W. BLAIR WALTRIP **W. Blair Waltrip**	Director
/s/ DAN S. WILFORD **Dan S. Wilford**	Director
/s/ RICK BERRY **Rick Berry**	Chief Financial Officer (Principal Financial and Accounting Officer)

Index to exhibits

Exhibit Number	Description
3.1	Articles of Incorporation of the Company, as amended (Filed as Exhibit 3.1 to the Company's Form 10-K for the year ending December 31, 2001 and incorporated herein by reference).
3.2	Amended and Restated Bylaws of the Company (Filed as an exhibit to the Company's Form 10-K for the year ending December 31, 1998. (File No. 333-65417) and incorporated herein by reference).
10.1	Asset Purchase Agreement dated July 13, 2000, among Energy Recovery Resources, Inc., TEI, Inc., Sanders Morris Harris Group Inc. and U.S. Filter Recovery Services (Mid-Atlantic), Inc. (Filed as Exhibit 2.1 to the Company's 8-K dated July 24, 2000 and incorporated herein by reference).
10.2	Employment Agreement dated June 30, 2000, between Sanders Morris Harris, Inc. and Arnold J. Barton (filed as Exhibit 10.1 to the Company's 8-K dated July 14, 2000 and incorporated herein by reference).
10.3	Registration Rights Agreement dated June 30, 2000, among Pinnacle Global Group, Inc., Arnold J. Barton, Richard D. Grimes, Jack D. Seibald, Allison Weiss, Neil Lauro, and John Conlon (Filed as Exhibit 10.2 to the Company's 8-K dated July 14, 2000 and incorporated herein by reference).
10.4	Merger Agreement dated June 30, 2000, among Pinnacle Global Group, Inc., Sanders Morris Harris Inc., Blackford Securities Corporation, Arnold J. Barton, Richard D. Grimes, Jack D. Seibald, Allison Weiss, Neil Lauro, and John Conlon (Filed as Exhibit 2.1 to the Company's 8-K dated July 14, 2000 and incorporated herein by reference).
10.5	Amended and Restated Agreement and Plan of Reorganization dated November 12, 1999 among the Company, Harris Webb & Garrison, Inc. ("HWG"), Sanders Morris Mundy Inc. ("SANDERS MORRIS MUNDY") and the SANDERS MORRIS MUNDY shareholders (Filed as Appendix A to the Definitive Proxy Statement on Schedule 14A of the Company dated December 6, 1999 and incorporated herein by reference).
10.6	Amended and Restated Plan of Merger dated November 12, 1999, among the Company, HWG and SANDERS MORRIS MUNDY (Filed as Appendix B to the Definitive Proxy Statement on Schedule 14A of the Company dated December 6, 1999 and incorporated herein by reference).
10.7	Amended and Restated Agreement and Plan of Reorganization dated October 2, 1998 among the Company, TEI, Inc. ("TEI"), HWG, Pinnacle Management & Trust Company ("PMT"), Spires Financial, L.P. ("Spires") and certain direct and indirect owners of HWG, PMT and Spires (Filed as Appendix A to the Proxy Statement/Prospectus of the Company dated December 31, 1998 (Reg. No. 333-65417) and incorporated herein by reference).
10.8	Plan of Merger dated October 2, 1998, among TEI, TEI Combination Corporation and the Company (Filed as Appendix B to the Proxy Statement/Prospectus of the Company dated December 31, 1998 (Reg. No. 333-65417) and incorporated herein by reference).
10.9	Plan of Merger dated October 2, 1998, among HWG, HWG Combination Corporation and the Company (Filed as Appendix C to the Proxy Statement/Prospectus of the Company dated December 31, 1998 (Reg. No. 333-65417) and incorporated herein by reference).
10.10	Plan of Merger dated October 2, 1998, among PMT, PMT Combination Corporation and the Company (Filed as Appendix D to the Proxy Statement/Prospectus of the Company dated December 31, 1998 (Reg. No. 333-65417) and incorporated herein by reference).
10.11	1998 Incentive Plan of the Company, as amended (Filed as Appendix A to the Definitive Proxy Statement on Schedule 14A of the Company dated May 3, 2002 and incorporated herein by reference).

10.12 Asset Purchase Agreement between Tanknology Environmental, Inc. and Jack Holder Enterprises, Inc. dated January 31, 1994 (Filed as an exhibit to TEI's Form 10-K for the year ending December 31, 1994 (File No. 0-18899) and incorporated herein by reference).

10.13 Asset Purchase Agreement between Tanknology/Engineered Systems, Inc., TEI, Inc. and Sorrento Electronics, Inc. dated December 23, 1997 (filed as an exhibit to TEI's Form 10-K for the year ending December 23, 1997 (File No. 0-18899) and incorporated herein by reference).

10.14 Sublease Agreement dated January 19, 1994 between Texas Commerce Bank National Association and Harris Webb & Garrison, Inc., as amended by that certain First Amendment to Sublease Agreement dated February 23, 1994, the Second Amendment to Sublease Agreement dated April 26, 1994, and the Third Amendment to Sublease Agreement dated January 19, 1995 (Filed as an exhibit to the Proxy Statement/Prospectus of the Company dated December 31, 1998 (Reg. No. 333-65417) and incorporated herein by reference).

10.15 Office Lease Agreement dated February 1, 1998 between 5599 San Felipe, Ltd. and Harris Webb & Garrison, Inc. (Filed as an exhibit to the Proxy Statement/Prospectus of the Company dated December 31, 1998 (Reg. No. 333-65417) and incorporated herein by reference).

10.16 Office Lease Agreement dated January 19, 1999 between 5599 San Felipe, Ltd. and the Company (Filed as an exhibit to the Company's Form 10-K for the year ending December 31, 1998 (File No. 333-65417) and incorporated herein by reference).

10.17 Letter Agreement dated April 7, 1999 between the Pershing Division of Donaldson, Lufkin Jenrette Securities Corporation and Harris Webb & Garrison, Inc.

10.18 Autotrust Agreement dated January 9, 1998 between SunGard Trust Systems Inc. and Pinnacle Management & Trust Company (Filed as an exhibit to the Proxy Statement/Prospectus of the Company dated December 31, 1998 (Reg. No. 333-65417) and incorporated herein by reference).

10.19 Letter of Agreement dated August 31, 1999 between Montgomery Correspondent Services, a division of Banc of America Securities LLC and Spires Financial, L.P.

10.20 Office Lease Agreement and related amendments dated September 25, 1996 between Texas Tower Limited and Sanders Morris Mundy Inc.

*21.1 List of Subsidiaries of the Registrant.

*23.1 Consent of KPMG LLP.

*31.1 Rule 13a-14(a)/15d – 14(a) Certification of Chief Executive Officer.

*31.2 Rule 13a-14(a)/15d – 14(a) Certification of Chief Financial Officer.

*32.1 Certification Pursuant to 18 U.S.C. 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*32.2 Certification Pursuant to 18 U.S.C. 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

---

* Filed herewith.

Reports on Form 8-K

On November 12, 2003, the Company filed a current report on Form 8-K relating to (i) the declaration by its board of directors of a cash dividend in the amount of $0.03 per share of common stock, and (ii) the Company's earnings report for the quarter ended September 30, 2003.

EXHIBIT 21.1
SUBSIDIARIES OF SANDERS MORRIS HARRIS GROUP INC.

Subsidiary	State of Organization
Sanders Morris Harris Inc.	Texas
Salient Capital Management, LLC	Texas
SMH Capital Advisors, Inc.	Texas
SMH Capital, Inc.	Texas
TEI, Inc.	Texas

EXHIBIT 23.1

Independent Auditors' Consent

The Board of Directors
Sanders Morris Harris Group Inc.:

We consent to incorporation by reference in the registration statements (No. 333-72325 and 333-37326) on Form S-8 of our report dated March 12, 2004, with respect to the consolidated balance sheet of Sanders Morris Harris Group Inc. and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2003, which report appears in the December 31, 2003 annual report on Form 10-K of Sanders Morris Harris Group Inc. Our report refers to a change in the method of accounting for goodwill in 2002.

/s/ KPMG LLP
KPMG LLP

Houston, Texas
March 12, 2004

Exhibit 31.1

CERTIFICATION

I, Ben T. Morris, certify that:

1. I have reviewed this annual report on Form 10-K of Sanders Morris Harris Group Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f), for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 12, 2004

/s/ BEN T. MORRIS

Ben T. Morris, Chief Executive Officer

Exhibit 31.2

CERTIFICATION

I, Rick Berry, certify that:

1. I have reviewed this annual report on Form 10-K of Sanders Morris Harris Group Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f), for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: March 12, 2004

/s/ RICK BERRY

Rick Berry, Chief Financial Officer

Exhibit 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Sanders Morris Harris Group Inc. (the "Company") on Form 10-K for the period ended December 31, 2003 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, I, Ben T. Morris, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ BEN T. MORRIS
Ben T. Morris
Chief Executive Officer

March 12, 2004

A signed original of this written statement required by Section 906 has been provided to Sanders Morris Harris Group Inc. and will be retained by Sanders Morris Harris Group Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Exhibit 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report of Sanders Morris Harris Group Inc. (the "Company") on Form 10-K for the period ended December 31, 2003 (the "Report"), as filed with the Securities and Exchange Commission on the date hereof, I, Rick Berry, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ RICK BERRY
Rick Berry
Chief Financial Officer

March 12, 2004

A signed original of this written statement required by Section 906 has been provided to Sanders Morris Harris Group Inc. and will be retained by Sanders Morris Harris Group Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

Corporate Information

BOARD OF DIRECTORS

GEORGE L. BALL [A]
Chairman

RICHARD E. BEAN [B]

DONALD R. CAMPBELL [B, D]

ROBERT E. GARRISON II [A, D]
President

TITUS H. HARRIS, JR.
Executive Vice President

BEN T. MORRIS [A]
Chief Executive Officer

NOLAN RYAN [C, D]

DON A. SANDERS [D]
Vice Chairman

JOHN H. STYLES [C]

W. BLAIR WALTRIP [A, C]

DAN S. WILFORD [B]

BUSINESS UNITS

ADMINISTRATION
Sandra J. Williams

CHARLOTTE CAPITAL
Robert W. Mathai/Ronald B. Saba

CORPORATE OPPORTUNITIES FUND
James C. Gale

COMPLIANCE
Thomas J. Anderson

ENVIRONMENTAL OPPORTUNITIES FUND I & II
Kenneth C. Leung

FINANCE
Rick Berry

FIXED INCOME DIVISION
Peter W. Badger

INFORMATION TECHNOLOGY
Michael Hart

INSTITUTIONAL EQUITY DIVISION
Tom Juda

INVESTMENT BANKING
William Sprague

KISSINGER FINANCIAL
William I. Kissinger

LIFE SCIENCES OPPORTUNITY FUND I & II
James C. Gale/Jerald S. Cobbs

OPERATIONS
Samuel Guardiola

PINNACLE TRUST CO.
Stephen M. Reckling/Stephen D. Strake

PRIME BROKERAGE
Neil Shaughnessy/Thomas Schirripa

PRIVATE CLIENT SERVICES
R. James Moeller

SANDERS OPPORTUNITY FUND
Don A. Sanders/Brad D. Sanders

SALIENT PARTNERS
John Blaisdell/Andrew Linbeck/ A. Haag Sherman

SMH ASSET MANAGEMENT
Robert E. Garrison II

SMH CAPITAL ADVISORS
Jeffrey A. Cummer/Dwayne A. Moyers

SMH PARTNERS
William S. Floyd IV

TRADING
Bret D. Sanders

INVESTOR RELATIONS

To obtain information about the Company, please visit our website at www.smhgroup.com or telephone the corporate office:

Rick Berry
713.993.4614

CORPORATE ADDRESS

Sanders Morris Harris Group Inc.
600 Travis, Suite 3100
Houston, Texas 77002
713.224.3100
www.smhgroup.com

INDEPENDENT ACCOUNTANTS

KPMG
Houston, Texas

TRANSFER AGENT AND REGISTRAR

For inquiries concerning shareholder records or certificates, please write or telephone:

Computershare Investor Services LLC
2 North LaSalle Street
P.O. Box 1869
Chicago, Illinois 60690-1689
312.588.4990
312.293.5999 FAX

Shareholders whose certificates are missing or destroyed should immediately notify the transfer agent. In the event of any change of address, please notify the transfer agent in writing or visit the website at www.us.computershare.com.

A Member of Executive Committee
B Member of Audit Committee
C Member of Compensation Committee
D Member of Nominating Committee

Sanders Morris Harris Group

600 TRAVIS, SUITE 3100
HOUSTON, TEXAS 77002
713.224.3100 • FAX 713.224.1101
WWW.SMHGROUP.COM