

KNIGHT CAPITAL GROUP, INC.

Form 10-Q

May 10, 2006

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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2006**

OR

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

001-14223

Commission File Number

KNIGHT CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

22-3689303

(I.R.S. Employer Identification Number)

545 Washington Boulevard, Jersey City, NJ 07310

(Address of principal executive offices and zip code)

Registrant's telephone number, including area code: (201) 222-9400

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

At May 9, 2006 the number of shares outstanding of the Registrant's Class A Common Stock was 104,382,274 and there were no shares outstanding of the Registrant's Class B Common Stock as of such date.

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KNIGHT CAPITAL GROUP, INC.

FORM 10-Q QUARTERLY REPORT

For the Quarter Ended March 31, 2006

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****KNIGHT CAPITAL GROUP, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(Unaudited)

	For the three months ended March 31,	
	2006	2005
Revenues		
Commissions and fees	\$ 98,862,709	\$ 70,116,011
Net trading revenue	80,039,151	37,421,828
Asset management fees	70,511,043	17,880,667
Interest and dividends, net	3,313,976	2,339,800
Investment income and other	23,728,941	9,798,564
Total revenues	276,455,820	137,556,870
Transaction-based expenses		
Execution and clearance fees	28,924,406	23,546,783
Soft dollar and commission recapture expense	17,707,700	15,484,575
Payments for order flow and ECN rebates	9,873,398	7,404,075
Total transaction-based expenses	56,505,504	46,435,433
Revenues, net of transaction-based expenses	219,950,316	91,121,437
Other direct expenses		
Employee compensation and benefits	99,556,170	56,857,441
Communications and data processing	7,638,143	7,813,959
Professional fees	6,383,123	3,776,416
Depreciation and amortization	4,407,695	4,302,413
Occupancy and equipment rentals	3,352,487	4,122,656
Business development	2,122,317	1,293,336
Writedown of assets and lease loss accrual	7,997,434	
Other	6,448,370	2,653,746
Total other direct expenses	137,905,739	80,819,967
Income from continuing operations before income taxes	82,044,577	10,301,470
Income tax expense	32,912,536	4,281,491

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Net income from continuing operations	49,132,041	6,019,979
Loss from discontinued operations, net of tax		(265,927)
Net income	\$ 49,132,041	\$ 5,754,052
Basic earnings per share from continuing operations	\$ 0.49	\$ 0.06
Diluted earnings per share from continuing operations	\$ 0.47	\$ 0.05
Basic and diluted earnings per share from discontinued operations	\$	\$
Basic earnings per share	\$ 0.49	\$ 0.05
Diluted earnings per share	\$ 0.47	\$ 0.05
Shares used in computation of basic earnings per share	100,422,995	108,858,845
Shares used in computation of diluted earnings per share	104,129,560	112,409,158

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

Table of Contents**KNIGHT CAPITAL GROUP, INC.****CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION****(Unaudited)**

	March 31, 2006	December 31, 2005
Assets		
Cash and cash equivalents	\$ 209,788,170	\$ 230,591,067
Securities owned, held at clearing brokers, at market value	521,627,396	380,366,778
Receivable from brokers and dealers	373,697,872	229,828,734
Investment in Deephaven sponsored funds	277,997,650	281,656,753
Fixed assets and leasehold improvements, at cost, less accumulated depreciation and amortization	66,790,659	67,656,533
Strategic investments	45,144,858	31,896,425
Goodwill	49,182,880	47,682,880
Intangible assets, less accumulated amortization	29,038,309	29,773,442
Other assets	151,728,350	116,563,732
Total assets	\$ 1,724,996,144	\$ 1,416,016,344
Liabilities and Stockholders Equity		
Liabilities		
Securities sold, not yet purchased, at market value	\$ 505,315,801	\$ 345,457,499
Payable to brokers and dealers	121,810,022	35,102,415
Accrued compensation expense	98,081,170	117,763,834
Accrued expenses and other liabilities	113,866,013	94,244,447
Total liabilities	839,073,006	592,568,195
Stockholders equity		
Class A Common Stock, \$0.01 par value; Shares authorized: 500,000,000; Shares issued : 140,829,796 at March 31, 2006 and 139,745,722 at December 31, 2005; Shares outstanding: 103,817,270 at March 31, 2006 and 102,966,359 at December 31, 2005	1,408,278	1,397,457
Additional paid-in capital	462,505,230	452,839,356
Retained earnings	702,645,732	653,513,691
Treasury stock, at cost; 37,012,526 shares at March 31, 2006 and 36,779,363 shares at December 31, 2005	(297,194,792)	(294,652,742)
Accumulated other comprehensive income, net of tax	16,558,690	10,350,387
Total stockholders equity	885,923,138	823,448,149
Total liabilities and stockholders equity	\$ 1,724,996,144	\$ 1,416,016,344

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

Table of Contents**KNIGHT CAPITAL GROUP, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(Unaudited)

	For the three months ended March 31,	
	2006	2005 Revised*
Cash flows from operating activities		
Net income	\$ 49,132,041	\$ 5,754,052
Loss from discontinued operations, net of tax		(265,927)
	<u>49,132,041</u>	<u>6,019,979</u>
Income from continuing operations, net of tax	49,132,041	6,019,979
Adjustments to reconcile income from continuing operations, net of tax to net cash used in operating activities		
Depreciation and amortization	4,407,695	4,302,413
Stock based compensation	5,660,043	2,946,743
Deferred rent	220,166	146,341
Writedown of assets and lease loss accrual	7,997,434	
Unrealized loss (gain) on strategic investments	1,497,434	(280,432)
Unrealized (gain) loss on investments in Deephaven sponsored funds	(18,950,897)	172,495
Operating activities from discontinued operations		(265,927)
(Increase) decrease in operating assets		
Securities owned	(141,260,618)	(25,386,835)
Receivable from brokers and dealers	(143,869,138)	70,476,531
Other assets	(39,452,182)	33,445,613
Increase (decrease) in operating liabilities		
Securities sold, not yet purchased	159,858,302	4,607,294
Payable to brokers and dealers	86,707,607	(26,966,674)
Accrued compensation expense	(19,682,664)	(74,437,605)
Accrued expenses and other liabilities	11,403,966	(43,171,902)
	<u>(36,330,811)</u>	<u>(48,391,966)</u>
Net cash used in operating activities	(36,330,811)	(48,391,966)
Cash flows from investing activities		
Purchases of fixed assets and leasehold improvements	(2,806,688)	(13,036,788)
Redemption of (investment in) Deephaven sponsored funds	22,610,000	(100,000,000)
Proceeds from (purchases of) strategic investments	(4,250,000)	1,939,166
Contingency payment on purchase of business	(1,500,000)	
	<u>14,053,312</u>	<u>(111,097,622)</u>
Net cash provided by (used in) investing activities	14,053,312	(111,097,622)
Cash flows from financing activities		
Stock options exercised	2,768,339	11,729,152
Income tax benefit on stock awards exercised	1,248,313	3,822,249
Cost of common stock repurchased	(2,542,050)	(68,967,976)
	<u>1,474,602</u>	<u>(53,416,575)</u>
Net cash provided by (used in) financing activities	1,474,602	(53,416,575)
Decrease in cash and cash equivalents	(20,802,897)	(212,906,163)
Cash and cash equivalents at beginning of period	230,591,067	445,539,282

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Cash and cash equivalents at end of period	\$ 209,788,170	\$ 232,633,119
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$ 144,864	\$ 37,126
Cash paid for income taxes	\$ 23,869,294	\$ 45,295,349

* Amounts have been revised to separately disclose discontinued operations. See Note 2 Significant Accounting Policies

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

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2006

(Unaudited)

1. Organization and Description of the Business

Knight Capital Group, Inc. and its subsidiaries (the Company) have two operating business segments, Asset Management and Global Markets, as well as a Corporate segment. As of March 31, 2006, the Company's operating business segments from continuing operations comprised the following operating subsidiaries:

Asset Management

Deephaven Capital Management LLC (Deephaven) is the investment adviser to and sponsor of the Deephaven investment funds (the Deephaven Funds). Deephaven also has a U.K. registered investment adviser subsidiary, which is regulated by the Financial Services Authority (FSA) in the U.K., and a Hong Kong registered investment adviser subsidiary, which is regulated by the Hong Kong Securities and Futures Commission.

Global Markets

Knight Equity Markets, L.P. (KEM) operates as a market-maker in over-the-counter (OTC) equity securities, primarily those traded in The Nasdaq Stock Market and on the OTC Bulletin Board (OTCBB). KEM also operates the Company's domestic institutional sales business. Additionally, Donaldson & Co. (Donaldson), a division of KEM, offers soft dollar and commission recapture services. KEM is a broker-dealer registered with the Securities and Exchange Commission (SEC or Commission) and is a member of the National Association of Securities Dealers (NASD), the National Stock Exchange, the Pacific Stock Exchange and the National Futures Association (NFA).

Knight Capital Markets LLC (KCM) operates as a market-maker in the Nasdaq Intermarket over-the-counter market for New York Stock Exchange (NYSE) and American Stock Exchange (AMEX) listed securities. KCM is a broker-dealer registered with the SEC and is a member of the NASD.

Knight Equity Markets International Limited (KEMIL) is a U.K. registered broker-dealer that provides execution services for predominately European institutional and broker-dealer clients in U.S., European and international equities. KEMIL is authorized and regulated by the FSA and is a member of the London Stock Exchange, Euronext and Deutsche Börse. In March 2006, KEMIL became a member of the OMX Finland, OMX Sweden, OMX Norway and virt-x stock exchanges.