

KNIGHT CAPITAL GROUP, INC.

Form 10-Q

November 09, 2010

[Table of Contents](#)

UNITED STATES
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 SEPTEMBER 30, 2010**

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

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

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

As of November 5, 2010 the number of shares outstanding of the Registrant's Class A Common Stock was 98,129,871 and there were no shares outstanding of the Registrant's Class B Common Stock.

Table of Contents

KNIGHT CAPITAL GROUP, INC.
FORM 10-Q QUARTERLY REPORT
For the Quarter Ended September 30, 2010

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION:

| | | |
|---------|--|----|
| Item 1. | <u>Financial Statements (Unaudited)</u> | 3 |
| | <u>Consolidated Statements of Operations</u> | 3 |
| | <u>Consolidated Statements of Financial Condition</u> | 4 |
| | <u>Consolidated Statements of Cash Flows</u> | 5 |
| | <u>Notes to Consolidated Financial Statements</u> | 6 |
| Item 2. | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 34 |
| Item 3. | <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 54 |
| Item 4. | <u>Controls and Procedures</u> | 56 |

PART II OTHER INFORMATION:

| | | |
|----------|--|----|
| Item 1. | <u>Legal Proceedings</u> | 57 |
| Item 1A. | <u>Risk Factors</u> | 57 |
| Item 2. | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 58 |
| Item 3. | <u>Defaults Upon Senior Securities</u> | 59 |
| Item 5. | <u>Other Information</u> | 59 |
| Item 6. | <u>Exhibits</u> | 59 |
| | <u>Signatures</u> | 60 |

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 September 30, | | For the nine months ended September 30, | |
|---|---|------------------|--|------------------|
| | 2010 | 2009 | 2010 | 2009 |
| | (In thousands, except per share amounts) | | | |
| Revenues | | | | |
| Commissions and fees | \$ 157,121 | \$ 177,025 | \$ 494,626 | \$ 503,532 |
| Net trading revenue | 79,847 | 119,595 | 392,775 | 354,459 |
| Interest, net | 92 | (1,050) | 853 | (2,687) |
| Investment income and other, net | 2,449 | 4,360 | 1,768 | 3,847 |
| Total revenues | 239,509 | 299,930 | 890,022 | 859,151 |
| Expenses | | | | |
| Employee compensation and benefits | 115,730 | 139,334 | 412,775 | 384,135 |
| Execution and clearance fees | 44,167 | 50,430 | 134,150 | 121,953 |
| Communications and data processing | 17,180 | 15,781 | 50,309 | 43,850 |
| Depreciation and amortization | 11,269 | 8,777 | 30,338 | 25,223 |
| Interest | 7,501 | 713 | 17,112 | 2,669 |
| Occupancy and equipment rentals | 6,630 | 5,930 | 19,332 | 17,180 |
| Payments for order flow | 6,598 | 17,737 | 28,712 | 57,813 |
| Business development | 4,451 | 4,058 | 14,991 | 13,497 |
| Professional fees | 3,976 | 3,410 | 12,762 | 9,410 |
| Restructuring | 16,731 | - | 16,731 | - |
| Writedown of assets and lease loss accrual (benefit), net | - | - | 1,032 | (9,996) |
| Other | 5,163 | 4,003 | 14,579 | 11,739 |
| Total expenses | 239,396 | 250,173 | 752,823 | 677,473 |
| Income from continuing operations before income taxes | 113 | 49,757 | 137,199 | 181,678 |
| Income tax expense | 45 | 19,278 | 54,578 | 73,360 |
| Income from continuing operations, net of tax | 68 | 30,479 | 82,621 | 108,318 |
| Income (loss) from discontinued operations, net of tax | 135 | (1,253) | (215) | (34,228) |
| Net income | \$ 203 | \$ 29,226 | \$ 82,406 | \$ 74,090 |
| Basic earnings per share from continuing operations | \$ 0.00 | \$ 0.34 | \$ 0.92 | \$ 1.22 |
| Diluted earnings per share from continuing operations | \$ 0.00 | \$ 0.32 | \$ 0.88 | \$ 1.16 |

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

| | | | | |
|--|---------|-----------|---------|-----------|
| Basic earnings per share from discontinued operations | \$ 0.00 | \$ (0.01) | \$ 0.00 | \$ (0.38) |
| Diluted earnings per share from discontinued operations | \$ 0.00 | \$ (0.01) | \$ 0.00 | \$ (0.37) |
| Basic earnings per share | \$ 0.00 | \$ 0.33 | \$ 0.92 | \$ 0.83 |
| Diluted earnings per share | \$ 0.00 | \$ 0.31 | \$ 0.88 | \$ 0.79 |
| Shares used in computation of basic earnings per share | 90,405 | 89,278 | 89,809 | 88,919 |
| Shares used in computation of diluted earnings per share | 93,278 | 93,958 | 94,054 | 93,532 |

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)**

| | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| | (In thousands) | |
| ASSETS | | |
| Cash and cash equivalents | \$ 480,871 | \$ 427,106 |
| Financial instruments owned, at fair value | 1,358,406 | 926,589 |
| Collateralized agreements: | | |
| Securities borrowed | 1,639,694 | 394,417 |
| Receivable from brokers, dealers and clearing organizations | 527,614 | 500,143 |
| Fixed assets and leasehold improvements, at cost, less accumulated depreciation and amortization | 114,176 | 98,696 |
| Investments | 86,456 | 118,619 |
| Goodwill | 317,650 | 265,530 |
| Intangible assets, less accumulated amortization | 91,497 | 93,332 |
| Other assets | 191,564 | 189,592 |
| Total assets | \$ 4,807,928 | \$ 3,014,024 |
| LIABILITIES & EQUITY | | |
| Liabilities | | |
| Financial instruments sold, not yet purchased, at fair value | \$ 1,161,283 | \$ 639,259 |
| Collateralized financings: | | |
| Securities loaned | 1,030,730 | 550,226 |
| Financial instruments sold under agreements to repurchase | 230,000 | - |
| Other secured financings | 41,405 | - |
| Payable to brokers, dealers and clearing organizations | 405,048 | 155,148 |
| Accrued compensation expense | 161,312 | 205,282 |
| Accrued expenses and other liabilities | 123,359 | 109,987 |
| Credit facility | - | 140,000 |
| Long-term debt | 307,952 | - |
| Total liabilities | 3,461,089 | 1,799,902 |
| Equity | | |
| Knight Capital Group, Inc. stockholders' equity | | |
| Class A common stock | 1,622 | 1,586 |
| Shares authorized: 500,000 at September 30, 2010 and at December 31, 2009; Shares issued: 162,183 at September 30, 2010 and 158,641 at December 31, 2009; | | |
| Shares outstanding: 97,607 at September 30, 2010 and 92,791 at December 31, 2009 | | |
| Additional paid-in capital | 794,626 | 746,778 |
| Retained earnings | 1,308,230 | 1,229,112 |
| Treasury stock, at cost; 64,576 shares at September 30, 2010 and 65,850 shares at December 31, 2009 | (758,057) | (763,974) |
| Accumulated other comprehensive loss | (204) | - |
| Total Knight Capital Group, Inc. stockholders' equity | 1,346,217 | 1,213,502 |
| Noncontrolling interests | 622 | 620 |

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

| | | |
|-------------------------------------|--------------|--------------|
| Total equity | 1,346,839 | 1,214,122 |
| Total liabilities and equity | \$ 4,807,928 | \$ 3,014,024 |

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 nine months ended September 30, | |
|---|--|-------------|
| | 2010 | 2009 |
| | (In thousands) | |
| Cash flows from operating activities | | |
| Net income | \$ 82,406 | \$ 74,090 |
| Loss from discontinued operations, net of tax | (215) | (34,228) |
| Income from continuing operations, net of tax | 82,621 | 108,318 |
| Adjustments to reconcile income from continuing operations, net of tax to net cash used in operating activities | | |
| Stock-based compensation | 39,662 | 35,975 |
| Depreciation and amortization | 30,338 | 25,223 |
| Debt discount accretion and other debt related expenses | 7,919 | - |
| Deferred rent | 3,381 | 1,101 |
| Writedown of assets and lease loss accrual (benefit), net | 1,032 | (9,996) |
| Unrealized loss (gain) on investments | 2,558 | (1,952) |
| Operating activities from discontinued operations | (477) | (6,157) |
| (Increase) decrease in operating assets | | |
| Financial instruments owned, at fair value | (406,446) | (521,058) |
| Securities borrowed | (1,245,277) | (133,964) |
| Receivable from brokers, dealers and clearing organizations | (27,471) | (228,907) |
| Other assets | 5,369 | (4,024) |
| Increase (decrease) in operating liabilities | | |
| Financial instruments sold, not yet purchased, at fair value | 492,265 | 352,142 |
| Securities loaned | 480,504 | 81,063 |
| Financial instruments sold under agreements to repurchase | 230,000 | - |
| Other secured financings | 41,405 | - |
| Payable to brokers and dealers | 249,899 | 300,192 |
| Accrued compensation expense | (41,410) | 2,594 |
| Accrued expenses and other liabilities | 11,046 | (27,060) |
| Net cash used in operating activities | (43,082) | (26,510) |
| Cash flows from investing activities | | |
| Distributions from investments | 37,485 | 58,738 |
| Purchases of investments | (7,887) | (8,913) |
| Purchases of fixed assets and leasehold improvements | (36,807) | (32,446) |
| Purchase of noncontrolling interest | (1,000) | - |
| Purchase of customer list | (1,000) | - |
| Purchase of business, net of cash acquired | (14,835) | - |
| Net cash (used in) provided by investing activities | (24,044) | 17,379 |
| Cash flows from financing activities | | |
| Repayment of credit facility | (140,000) | - |
| Proceeds from issuance of cash convertible notes | 363,808 | - |
| Purchase of call options | (73,750) | - |
| Proceeds from issuance of warrants | 15,000 | - |
| Stock options exercised | 1,304 | 10,288 |
| Income tax benefit on stock awards exercised | 205 | 3,518 |

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

| | | |
|--|------------|------------|
| Cost of common stock repurchased | (45,472) | (12,748) |
| Financing activities from discontinued operations | - | (6,178) |
| Net cash provided by (used in) financing activities | 121,095 | (5,120) |
| Effect of exchange rate changes on cash and cash equivalents | (204) | - |
| Increase (decrease) in cash and cash equivalents | 53,765 | (14,251) |
| Cash and cash equivalents at beginning of period | 427,106 | 416,957 |
| Cash and cash equivalents at end of period | \$ 480,871 | \$ 402,706 |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 16,565 | \$ 2,623 |
| Cash paid for income taxes | \$ 57,284 | \$ 82,171 |

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

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization and Description of the Business

Knight Capital Group, Inc. (collectively with its subsidiaries, the Company) has three operating segments, (i) Equities, (ii) Fixed Income, Currencies and Commodities (FICC) and (iii) Corporate. As of September 30, 2010, the Company's operating segments comprised the following:

Equities

Knight Equity Markets, L.P. (KEM) primarily operates as a market maker in equity securities quoted and traded on the Nasdaq Stock Market and quoted on the OTC Bulletin Board and Pink OTC Markets. KEM also operates the Company's primary domestic institutional equity sales business.

Knight Capital Markets LLC (KCM) primarily operates as a market maker in the over-the-counter market for NYSE, NYSE Amex Equities and NYSE Arca listed securities. KCM also provides capital markets services to corporate issuers and private companies.

Knight Capital Europe Limited (KCEL) is a U.K. registered broker-dealer that provides trade execution services for institutional and broker-dealer clients in U.S., European and Asian equities. KCEL also provides trade execution services for institutional clients in U.S., European and Asian fixed income and foreign exchange products.

Knight Capital Asia Limited LLC (KCAL) provides trade execution services in Asian, U.S. and European equities and fixed income to institutional clients worldwide.

Knight Direct LLC (Knight Direct) provides institutions with direct market access trading through Knight Direct™, an advanced electronic platform. Knight Direct offers a suite of algorithms that allow buy- and sell-side clients to more effectively source liquidity and manage the trading process as well as maintain anonymity, reduce market impact and lower transaction costs. Knight Direct's European business is operated through KCEL.

Knight Clearing Services LLC (KCS) operates as a self clearing broker-dealer that provides equity settlement and clearance services for the Company's broker-dealer subsidiaries. KCS is a member of The Depository Trust Company and the National Securities Clearing Corporation. KCS is a registered clearing member of NYSE, Nasdaq, ISE, NSX, Chicago Stock Exchange, CBOE Stock Exchange, Nasdaq OMX, Nasdaq OMX BX, Nasdaq OMX PHLX, NYSE Arca and BATS.

FICC

Knight Libertas Holdings LLC and its affiliates (collectively, Knight Fixed Income) provide research, sales and trading across a broad range of fixed income securities, including high-yield and high-grade corporate bonds, distressed debt, asset- and mortgage-backed securities, federal agency securities, convertible bonds, hybrid securities, syndicated bank loans and emerging

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

markets. Knight Fixed Income also provides capital markets services to corporate issuers and private companies. Knight Fixed Income's European business is operated through KCEL.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

Hotspot Holdings FX, Inc. and its subsidiaries (Hotspot) provide institutions and dealers with spot foreign exchange, gold and silver executions through an advanced, fully electronic platform. Hotspot s European business is operated through KCEL.

Knight BondPoint, Inc. (Knight BondPoint) provides electronic access and trade execution services for the retail fixed income market.

Urban Financial Group, Inc. (Urban), acquired on July 1, 2010, is an originator of direct and brokered residential mortgage loans and an originator of home equity conversion mortgages, or reverse mortgages, insured by the Federal Housing Administration. Knight s domestic broker-dealers are registered with the SEC, and are members of one or more self-regulatory organizations, including the Financial Industry Regulatory Authority (FINRA), the Municipal Securities Rulemaking Board (MSRB), and the National Futures Association (NFA). Collectively, Knight s domestic broker-dealers are members of all major U.S. stock, options and futures exchanges and marketplaces. Urban is regulated by the U.S. Department of Housing and Urban Development (HUD). KCEL is authorized and regulated by the U.K. Financial Services Authority (FSA) and is a member of most European Regulated Markets and Multilateral Trading Facilities. KCAL is a broker-dealer registered as an exchange participant with the Hong Kong Stock Exchange and is regulated by the Hong Kong Securities and Futures Commission (SFC).

Corporate

The Corporate segment invests in strategic financial services-oriented opportunities, allocates, deploys and monitors all capital, and maintains all corporate overhead expenses and all other expenses that are not attributable to the Equities and FICC segments. Corporate overhead expenses consist of compensation for senior executives and other employees of the corporate holding company, expenses from legal and other professional services relating to corporate matters as well as directors fees and directors and officers insurance.

Discontinued Operations

Deephaven Capital Management LLC and its subsidiaries (collectively, Deephaven) was the former registered investment adviser to, and sponsor of, the Deephaven investment funds (the Deephaven Funds). During the first quarter of 2009, Deephaven completed the sale of substantially all of its assets to Stark & Roth, Inc. (together with its affiliates, Stark) with Stark agreeing to assume certain limited liabilities of Deephaven. At that time, Deephaven was replaced by Stark as the investment manager, managing member and general partner for the Deephaven Funds and the Company exited the Deephaven business. As a result of this sale, Deephaven was classified as a discontinued operation.

2. Significant Accounting Policies

Basis of consolidation and form of presentation

The accompanying unaudited Consolidated Financial Statements, prepared in conformity with accounting principles generally accepted in the United States of America (GAAP), should be read in conjunction with the audited Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009. These unaudited Consolidated Financial

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

Statements reflect all adjustments that are, in the opinion of management, necessary for a fair statement of the results for the interim periods presented. All such adjustments are of a normal recurring nature. Certain footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations, although the Company believes that the disclosures herein are adequate to make the information presented not misleading. All significant intercompany transactions and balances have been eliminated. Interim period operating results may not be indicative of the operating results for a full year.

Certain reclassifications have been made to the prior periods Consolidated Financial Statements in order to conform to the current period presentation. Such reclassifications had no effect on previously reported Net income.

The Company consolidates all of its wholly-owned subsidiaries as well as any investment in which it is considered to be the primary beneficiary of a variable interest entity (VIE). The Company performs a qualitative assessment to determine if a VIE should be consolidated. The primary attributes the Company assesses include the entity's capital structure and voting power. The Company will consolidate a VIE if it has both i) the power to direct the activities of a VIE that most significantly impact the entity's economic performance and ii) the obligation to absorb losses of the entity that could potentially be significant to the VIE or the right to receive benefits from the entity that could potentially be significant to the VIE.

Cash and cash equivalents

Cash and cash equivalents include money market accounts, which are payable on demand, and short-term investments with an original maturity of less than 90 days. The carrying amount of such cash equivalents approximates their fair value due to the short-term nature of these instruments.

Market-making, trading and sales activities

Financial instruments owned and Financial instruments sold, not yet purchased, which primarily consist of listed and OTC equity securities, are carried at fair value and are recorded on a trade date basis. Net trading revenue (trading gains, net of trading losses) and commissions (which includes commission equivalents earned on institutional client orders) and related expenses are also recorded on a trade date basis. The Company's third party clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers, for facilitating the settlement and financing of securities transactions. Interest income and interest expense which has been netted on the Consolidated Statements of Operations, is presented in the following table (in millions).

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|-------------------------|---|-------------|--|-------------|
| | 2010 | 2009 | 2010 | 2009 |
| Interest income | \$ 3.9 | \$ 0.7 | \$ 9.2 | \$ 2.1 |
| Interest expense | (3.8) | (1.7) | (8.3) | (4.8) |
| Interest, net | \$ 0.1 | \$ (1.1) | \$ 0.9 | \$ (2.7) |

Totals may not add due to rounding.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS **Continued**

(Unaudited)

Dividend income relating to securities owned and dividend expense relating to securities sold, not yet purchased, derived from the Company's market-making activities are included as a component of Net trading revenue on the Consolidated Statements of Operations. Net trading revenue includes dividend income and expense presented in the following table (in millions).

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|-------------------------|---|----------|--|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Dividend income | \$ 5.3 | \$ 7.2 | \$ 16.4 | \$ 16.7 |
| Dividend expense | \$ (3.5) | \$ (7.1) | \$ (11.1) | \$ (15.0) |

Payments for order flow primarily represent payments to broker-dealer clients, in the normal course of business, for directing their order flow in U.S. equities to the Company.

Collateralized agreements and financings

Collateralized agreements consist of securities borrowed. Collateralized financings consist of securities loaned, financial instruments sold under agreements to repurchase, and other secured financings.

Securities borrowed and securities loaned transactions are accounted for as collateralized financing transactions and are recorded at the amount of cash collateral advanced or received, which approximates fair value. Securities borrowed transactions facilitate the settlement process and require the Company to deposit cash or other collateral with the lender. Securities loaned transactions help finance the Company's securities inventory whereby the Company lends stock in exchange for the receipt of cash or other collateral from the borrower. In these transactions, the Company receives or lends cash or other collateral in an amount generally in excess of the market value of the applicable securities borrowed or loaned. The Company monitors the market value of securities borrowed or loaned on a daily basis, with additional collateral obtained or refunded as necessary.

Financial instruments sold under agreements to repurchase are used to finance securities inventory and are recorded at their contractual amount, which approximates fair value. The Company has entered into tri-party repurchase agreements which bear interest at negotiated rates. The Company receives cash and makes delivery of financial instruments to a custodian who monitors the market value of these securities on a daily basis. The market value of the securities delivered must be equal to or in excess of the principal amount loaned under the tri-party repurchase agreements plus the agreed upon margin requirement. The custodian may request additional collateral, if appropriate.

Other secured financings are additional contractual agreements used to finance securities inventory or loans and are recorded at their contractual amount, which approximates fair value. These agreements are short-term with durations of typically less than a month and bear interest at negotiated rates. The Company receives cash and pledges financial instruments or other assets to banks as collateral for these secured financing arrangements. The market value of the collateral delivered must be in excess of the principal amount loaned plus the agreed upon margin requirement under the secured financings. The banks may request additional collateral, if

appropriate.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

The Company's collateralized agreements and financings are recorded at amounts that approximate fair value. These items are not materially sensitive to shifts in interest rates because they are short-term in nature and are fully collateralized.

Estimated fair value of financial instruments

The Company values its financial instruments using a hierarchy of fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

The fair value hierarchy can be summarized as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that the Company has the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement. Changes in fair value are recognized in earnings each period for financial instruments that are carried at fair value.

The Company's financial instruments owned and financial instruments sold, not yet purchased will generally be classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices or broker or dealer quotations with reasonable levels of price transparency.

The types of instruments that trade in markets that are not considered to be active, but are valued based on observable inputs such as quoted market prices or alternative pricing sources with reasonable levels of price transparency, are generally classified within Level 2 of the fair value hierarchy.

As discussed in Footnote 8 Long-Term Debt, the Company entered into purchased call options and recorded an embedded conversion derivative concurrent with its issuance of long-term debt. The fair value of these options and derivative are determined using an option pricing model based on observable inputs such as implied volatility of the Company's common stock, risk-free interest rate, and other factors and, as such, are classified within Level 2 of the fair value hierarchy.

As of September 30, 2010, the Company's loans inventory, foreign currency forward contracts, investment in the Deephaven Funds and deferred compensation investments are also classified within Level 2.

Certain instruments are classified within Level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. For those instruments that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. As of September 30, 2010 and December 31, 2009, the Company did not hold any financial instruments that met the definition of Level 3.

The Company has elected to account for its loan inventory associated with the Urban business at fair value, as these assets are generally not held to maturity and the Company believes that fair value better reflects the economics of these loan transactions.

There were no transfers of financial instruments between levels of the fair value hierarchy for any periods presented.

Investments

Investments comprise strategic investments, deferred compensation investments and investment in the Deephaven Funds. Strategic investments include noncontrolling equity ownership interests and debt instruments held by the Company within its non-broker-dealer subsidiaries, primarily in financial services-related businesses. Strategic investments are accounted for under the equity method, at cost or at fair value. The equity method of accounting is used where the Company is considered to exert significant influence on the investee. Strategic investments are held at cost, less impairment if any, when the Company is not considered to exert significant influence on the investee. The equity method of accounting is generally used for investments in limited partnerships and limited liability companies that are held by the Company or any of its non-broker-dealer subsidiaries while strategic investments in corporations by such non-broker-dealers are generally held at adjusted cost. Deferred compensation investments in mutual funds and the investment in the Deephaven Funds are accounted for at fair value.

Strategic investments are reviewed on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If the Company determines that an impairment loss on a strategic investment has occurred due to a decline in fair value or other market conditions, the investment is written down to its estimated net realizable value.

The Company has several deferred compensation plan investments related to certain employees and directors. These plans provide a return to the participants based upon the performance of various investments. In order to hedge its liability under these plans, the Company generally acquires the underlying investments and holds such investments until the deferred compensation liabilities are satisfied. Changes in value of such investments are recorded in Investment income and other, net, with a corresponding charge or credit to Employee compensation and benefits on the Consolidated Statements of Operations.

Goodwill and intangible assets

The Company tests goodwill and intangible assets with an indefinite useful life for impairment annually or when an event occurs or circumstances change that signify the existence of impairment. The Company amortizes other intangible assets on a straight line basis over their useful lives and tests for recoverability whenever events indicate that the carrying amounts may not be recoverable.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

Treasury stock

The Company records its purchases of treasury stock at cost as a separate component of stockholders' equity. The Company obtains treasury stock through purchases in the open market or through privately negotiated transactions. The Company may re-issue treasury stock, at average cost, related to the acquisition of new businesses or, in certain instances, as inducement grants to new hires.

Foreign currency translation and foreign currency forward contracts

As a result of changes in the currencies in which the Company's foreign subsidiaries earn the majority of their revenues, the Company changed the functional currency of KCEL to the Pound Sterling from the U.S. dollar and KCAL to the Hong Kong dollar from the U.S. dollar, effective January 1, 2010. These changes were reflected prospectively and resulted in recording a \$2.4 million cumulative translation adjustment gain which is included in Accumulated other comprehensive loss, a \$0.9 million reduction in Fixed assets and leasehold improvements and a \$3.3 million reduction in Retained earnings on the Consolidated Statements of Financial Condition. For all other entities, the Company's functional currency is the U.S. dollar.

Assets and liabilities of foreign subsidiaries having non-U.S. dollar functional currencies are translated at exchange rates at the end of a period. Revenues and expenses are translated at average exchange rates during the period. Gains and losses resulting from translating foreign currency financial statements into U.S. dollars are included in other comprehensive income (loss) (see Footnote 9 - Comprehensive Income). Gains or losses resulting from foreign currency transactions are included in Investment income and other, net on the Company's Consolidated Statements of Operations. For the three and nine months ended September 30, 2010, losses of \$0.1 million and \$0.5 million, respectively, were recorded in Investment income and other, net on the Consolidated Statements of Operations.

The Company seeks to reduce the impact of fluctuations in foreign exchange rates on its net investment in certain non-U.S. operations through the use of foreign currency forward contracts. For foreign currency forward contracts designated as hedges, the Company assesses the risk management objectives and strategy, including identification of the hedging instrument, the hedged item and the risk exposure and how effectiveness is to be assessed prospectively and retrospectively. The ineffectiveness of the hedge is assessed based on the overall changes in the fair value of the forward contracts. For qualifying net investment hedges, the gains or losses, to the extent effective, are included in Accumulated other comprehensive loss on the Consolidated Statements of Financial Condition and the ineffective portion, if any, is recorded in Investment income and other, net on the Consolidated Statements of Operations.

Soft dollar and commission recapture expense

Under a commission management program, the Company allows institutional clients to allocate a portion of their gross commissions to pay for research and other services provided by third parties. As the Company acts as an agent in these transactions, it records such expenses on a net basis within Commissions and fees on the Consolidated Statements of Operations.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

Depreciation, amortization and occupancy

Fixed assets are depreciated on a straight-line basis over their estimated useful lives of three to seven years. Leasehold improvements are being amortized on a straight-line basis over the shorter of the life of the related office lease or the expected useful life of the assets. The Company capitalizes certain costs associated with the acquisition or development of internal-use software and amortizes the cost over the software's estimated useful life of three years, commencing at the time the software is placed in service.

The Company recognizes rent expense under operating leases with fixed rent escalations, lease incentives and free rent periods on a straight-line basis over the lease term beginning on the date the Company takes possession of or controls the use of the space, including during free rent periods.

Lease loss

The Company's policy is to identify excess real estate capacity and where applicable, accrue for related future costs, net of estimated sublease income. In determining the accrual, a nominal cash flow analysis is performed for lease losses initiated prior to December 31, 2002 and costs related to the excess capacity are accrued. For lease losses initiated after December 31, 2002, the Company's policy is to accrue future costs related to excess capacity using a discounted cash flow analysis.

In the event the Company is able to sublease the excess real estate after recording a lease loss, such accrual is adjusted to the extent the actual terms of subleased property differ from the assumptions used in the calculation of the accrual. In the event that the Company concludes that previously determined excess real estate is needed for the Company's use, such lease loss accrual will be adjusted accordingly. Any such adjustments to previous lease loss accruals are recorded in Writedown of assets and lease loss accrual (benefit), net on the Consolidated Statements of Operations.

Income taxes

The Company records deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and measures them using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. The Company evaluates the recoverability of future tax deductions by assessing the adequacy of future expected taxable income from all sources, including reversal of temporary differences and forecasted operating earnings. Net deferred tax assets and liabilities are included in Other assets and Accrued expenses and other liabilities, respectively, on the Consolidated Statements of Financial Condition.

Discontinued operations

Revenues and expenses associated with a separate segment or reporting unit that has been disposed of through closure or sale are included in Income (loss) from discontinued operations, net of tax on the Consolidated Statements of Operations. Assets and liabilities of discontinued operations are included in Other assets and Accrued expenses and other liabilities, respectively, on the Consolidated Statements of Financial Condition. Cash flows from discontinued operations are presented on the Consolidated Statements of Cash Flows within operating, investing and financing activities, as applicable, for all periods.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

Stock-based compensation

Stock-based compensation is measured based on the grant date fair value of the awards. These costs are amortized over the requisite service period, which is typically the vesting period.

Expected forfeitures are considered in determining stock-based employee compensation expense. For all periods presented, the Company recorded a benefit for expected forfeitures on all outstanding stock-based awards. The benefit recorded did not have a material impact on the results of operations in any of the periods presented.

The Company applies a non-substantive vesting period approach for stock-based awards whereby the expense is accelerated for those employees and directors that receive options and restricted stock units (RSUs) and are eligible to retire prior to the options or RSUs vesting.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

Accounting Standards Updates

Effective January 1, 2010, the Company adopted two Accounting Standards Updates (ASU), which were issued by the Financial Accounting Standards Board (FASB). The first ASU requires a reporting entity to disclose separately the amounts of transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. This ASU also clarifies existing disclosure requirements related to how assets and liabilities should be grouped by class and valuation techniques used for recurring and nonrecurring fair value measurements. Certain disclosure requirements of this ASU were effective for the Company beginning in the first quarter of 2010, while other disclosure requirements of this ASU are effective for financial statements issued for reporting periods beginning after December 15, 2010. Since these amended principles require only additional disclosures concerning fair value measurements, adoption did not and will not affect the Company's Consolidated Financial Statements.

The second ASU relates to the accounting for VIEs. This ASU significantly changed the criteria by which an enterprise determines whether or not it must consolidate a VIE. Under the new guidance, consolidation of a VIE requires both the power to direct the activities that most significantly impact the VIE's economic performance and the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits of the VIE that could potentially be significant to the VIE. The adoption of this ASU had no impact on the Company's Consolidated Financial Statements.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS** Continued

(Unaudited)

3. Fair Value Instruments

The Company's financial instruments recorded at fair value have been categorized based upon a fair value hierarchy, as described more fully in Footnote 2 Significant Accounting Policies. The following fair value hierarchy table presents information about the Company's financial assets and liabilities measured at fair value on a recurring basis (in millions):

| September 30, 2010 | Assets and Liabilities Measured at Fair Value on a Recurring Basis | | | Total |
|---|---|-----------------|-------------|-------------------|
| | Level 1 | Level 2 | Level 3 | |
| Assets | | | | |
| Financial instruments owned, at fair value: | | | | |
| Equities ⁽¹⁾ | \$ 1,227.7 | \$ - | \$ - | \$ 1,227.7 |
| U.S. government obligations | 3.3 | - | - | 3.3 |
| Corporate debt | 30.6 | - | - | 30.6 |
| Listed equity options | 13.5 | - | - | 13.5 |
| Loans inventory | - | 53.6 | - | 53.6 |
| Purchased call options | - | 29.8 | - | 29.8 |
| Total Financial instruments owned, at fair value | 1,275.0 | 83.4 | - | 1,358.4 |
| Deferred compensation investments ⁽²⁾ | - | 16.1 | - | 16.1 |
| Investment in Deephaven Funds ⁽²⁾ | - | 3.9 | - | 3.9 |
| Total fair value of financial instrument assets | \$ 1,275.0 | \$ 103.4 | \$ - | \$ 1,378.4 |
| Liabilities | | | | |
| Financial instruments sold, not yet purchased, at fair value: | | | | |
| Equities ⁽¹⁾ | \$ 1,069.1 | \$ - | \$ - | \$ 1,069.1 |
| U.S. government obligations | 37.3 | - | - | 37.3 |
| Listed equity options | 11.4 | - | - | 11.4 |
| Corporate debt | 0.4 | - | - | 0.4 |
| Embedded conversion derivative | - | 29.8 | - | 29.8 |
| Total return swap | - | 11.0 | - | 11.0 |
| Foreign currency forward contracts | - | 2.3 | - | 2.3 |
| Total fair value of financial instrument liabilities | \$ 1,118.2 | \$ 43.1 | \$ - | \$ 1,161.3 |

(1) Equities of \$257.9 million have been netted by their respective long and short positions by CUSIP number.

(2) Deferred compensation investments and investment in the Deephaven Funds are included within Investments on the Consolidated Statements of Financial Condition. Excluded from deferred compensation investments is \$3.0 million of Level 2 assets which relate to discontinued operations and are included within Other assets on the Consolidated Statements of Financial Condition.

Totals may not add due to rounding.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

| December 31, 2009 | Assets and Liabilities Measured at Fair Value on a Recurring Basis | | | |
|---|---|----------------|----------------|--------------|
| | Level 1 | Level 2 | Level 3 | Total |
| Assets | | | | |
| Financial instruments owned, at fair value: | | | | |
| Equities ⁽¹⁾ | \$ 921.1 | \$ - | \$ - | \$ 921.1 |
| U.S. government obligations | 3.5 | - | - | 3.5 |
| Listed equity options | 2.0 | - | - | 2.0 |
| Total Financial instruments owned, at fair value | 926.6 | - | - | 926.6 |
| Deferred compensation investments ⁽²⁾ | - | 45.0 | - | 45.0 |
| Investment in Deephaven Funds ⁽²⁾ | - | 8.5 | - | 8.5 |
| Total fair value of financial instrument assets | \$ 926.6 | \$ 53.5 | \$ - | \$ 980.0 |
| Liabilities | | | | |
| Financial instruments sold, not yet purchased, at fair value: | | | | |
| Equities ⁽¹⁾ | \$ 638.1 | \$ - | \$ - | \$ 638.1 |
| Listed equity options | 1.2 | - | - | 1.2 |
| Total fair value of financial instrument liabilities | \$ 639.3 | \$ - | \$ - | \$ 639.3 |

(1) Equities of \$191.1 million have been netted by their respective long and short positions by CUSIP number.

(2) Deferred compensation investments and investment in the Deephaven Funds are included within Investments on the Consolidated Statements of Financial Condition. Excluded from deferred compensation investments is \$10.5 million of Level 2 assets which relate to discontinued operations and are included within Other assets on the Consolidated Statements of Financial Condition.

Totals may not add due to rounding.

The following table summarizes the fair value of derivative instruments in the Consolidated Statements of Financial Condition and the effect of changes in fair value on the Consolidated Statements of Operations (in millions):

| Asset Derivatives | Balance Sheet Location | Fair Value as of | |
|--|--|---------------------------|--------------------------|
| | | September 30, 2010 | December 31, 2009 |
| Derivative instruments not designated as hedging instruments: | Financial instruments owned, at fair value | | |
| Purchased call options | | \$ 29.8 | \$ - |
| Listed equity options ⁽¹⁾ | | 13.5 | 2.0 |
| | | \$ 43.2 | \$ 2.0 |

Liability Derivatives

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

| Derivative instruments not designated as hedging instruments: | Financial instruments sold, not yet purchased, at fair value | |
|--|--|--------|
| Embedded conversion derivative | \$ 29.8 | \$ - |
| Listed equity options ⁽¹⁾ | 11.4 | 1.2 |
| | \$ 41.2 | \$ 1.2 |
| Derivative instruments designated as hedging instruments: | Financial instruments sold, not yet purchased, at fair value | |
| Foreign currency forward contracts | \$ 2.3 | \$ - |

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

- (1) As of September 30, 2010, the Company held 75,364 long and 79,244 short listed equity option contracts. As of December 31, 2009, the Company held 9,185 long and 5,675 short listed equity option contracts. The contracts are not subject to collateral requirements and are not netted.

Totals may not add due to rounding.

| Derivative instruments not designated as hedging instruments: | Statement of Operations / Other Comprehensive Income Location | Gain (Loss) Recognized For the Three Months Ended September 30, | |
|--|--|---|----------|
| | | 2010 | 2009 |
| Purchased call options | Investment income and other, net | \$ (21.2) | \$ - |
| Listed equity options | Net trading revenue | 1.9 | (2.6) |
| Embedded conversion derivative | Investment income and other, net | 21.2 | - |
| | | \$ 1.9 | \$ (2.6) |
| Derivative instruments designated as hedging instruments: | | | |
| Foreign currency forward contracts | Cumulative Translation Adjustment | \$ (2.3) | \$ - |

Totals may not add due to rounding.

| Derivative instruments not designated as hedging instruments: | Statement of Operations / Other Comprehensive Income Location | Gain (Loss) Recognized For the Nine Months Ended September 30, | |
|--|--|--|----------|
| | | 2010 | 2009 |
| Purchased call options | Investment income and other, net | \$ (44.0) | \$ - |
| Listed equity options | Net trading revenue | 1.7 | (8.6) |
| Embedded conversion derivative | Investment income and other, net | 44.0 | - |
| | | \$ 1.7 | \$ (8.6) |
| Derivative instruments designated as hedging instruments: | | | |
| Foreign currency forward contracts | Cumulative Translation Adjustment | \$ (2.3) | \$ - |

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

Totals may not add due to rounding.

At September 30, 2010, the Company had a foreign currency contract with a notional value of 55 million British pounds. The fair value of the contract was \$2.3 million and is included in Financial instruments sold, not yet purchased, at fair value on the Consolidated Statements of Financial Condition.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

4. Collateralized Transactions

The Company receives financial instruments as collateral in connection with securities borrowed. Such financial instruments generally consist of equity and convertible securities but may include obligations of the U.S. government, federal agencies, sovereignties and corporations. In most cases, the Company is permitted to deliver or repledge these financial instruments in connection with securities lending and other secured financings and meeting settlement requirements. As of September 30, 2010, the fair value of financial instruments received as collateral by the Company that it was permitted to deliver or repledge was \$1.41 billion, of which \$1.38 billion had been delivered or repledged, of which \$712.6 million could be repledged by the receiving counterparty. As of December 31, 2009, the fair value of financial instruments received as collateral by the Company that it was permitted to deliver or repledge was \$349.1 million, of which \$314.7 million had been delivered or repledged, all of which could be repledged by the receiving counterparty. The Company also pledges assets that it owns to counterparties who, in turn, are permitted to deliver or repledge them. Financial instruments pledged to counterparties that have the right to deliver or repledge them were \$278.7 million and \$212.5 million at September 30, 2010 and December 31, 2009, respectively, and are included in Financial instruments owned, at fair value on the Consolidated Statements of Financial Condition.

The Company enters into collateralized transactions in order to finance securities inventory positions. Under these transactions, the Company pledges certain financial instruments owned to collateralize repurchase agreements and other secured financings. Financial instruments owned and pledged to counterparties that did not have the right to sell or repledge such financial instruments consisted of equity securities with a fair value of \$261.6 million as of September 30, 2010 and are included in Financial instruments owned, at fair value on the Consolidated Statements of Financial Condition. Repurchase agreements and other secured financings are short-term and mature within one year.

Urban has committed collateralized financing facilities to finance its loan origination activity. At September 30, 2010, Urban had \$41.4 million borrowed under these committed collateralized financing facilities. None of the collateral that secures these financings can be repledged by the lenders.

5. Receivable from and Payable to brokers, dealers and clearing organizations

Amounts receivable from and payable to brokers, dealers and clearing organizations consist of the following (in millions):

| | September 30, 2010 | December 31, 2009 |
|------------------------------|-----------------------|----------------------|
| Receivable: | | |
| Clearing brokers and other | \$ 461.1 | \$ 412.7 |
| Securities failed to deliver | 66.5 | 87.5 |
| | \$ 527.6 | \$ 500.1 |
| Payable: | | |
| Clearing brokers and other | 354.9 | 92.8 |
| Securities failed to receive | 50.2 | 62.4 |
| | \$ 405.0 | \$ 155.1 |

Totals may not add due to rounding.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS **Continued**

(Unaudited)

6. Investments

Investments include strategic investments, deferred compensation investments related to employee and director deferred compensation plans and investment in Deephaven Funds. Investments consist of the following (in millions):

| | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| Strategic Investments: | | |
| Limited liability companies, limited partnerships and corporations accounted for under the equity method | \$ 61.2 | \$ 57.4 |
| Common stock of private companies representing less than 20% equity ownership held at adjusted cost | 0.3 | 0.3 |
| Debt instruments, held at amortized cost | 5.0 | 7.5 |
| Total Strategic Investments | 66.4 | 65.2 |
| Deferred compensation investments | 16.1 | 45.0 |
| Investment in Deephaven Funds | 3.9 | 8.5 |
| Total Investments | \$ 86.5 | \$ 118.6 |

Totals may not add due to rounding.

Included in the investment in limited liability companies at September 30, 2010 and December 31, 2009 is an equity investment in Direct Edge of \$45.4 million and \$41.3 million, respectively.

See Footnote 2 **Significant Accounting Policies** for a discussion of valuation of Investments.

7. Goodwill and Intangible Assets

Goodwill and intangible assets with indefinite useful lives are tested for impairment annually or when an event occurs or circumstances change that signify the existence of impairment. As part of the test for impairment, the Company considers the profitability of the respective segment or reporting unit, an assessment of the fair value of the respective segment or reporting unit as well as the overall market value of the Company compared to its net book value. In June 2010, the Company tested for the impairment of goodwill and intangible assets with indefinite lives.

Amortizable intangibles are tested for recoverability whenever events indicate that the carrying amounts may not be recoverable. During the second quarter of 2010, the Company discontinued the use of the Libertas trade name and wrote off the remaining book value of \$0.3 million. During the second quarter of 2009, the Company discontinued the use of the Donaldson trade name and wrote off the remaining book value of \$2.4 million. No other events occurred during the three and nine months ended September 30, 2010 and 2009 that would indicate that the carrying amounts of the Company's goodwill or intangible assets may not be recoverable.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

The following table summarizes the Company's Goodwill and Intangible assets, net of accumulated amortization, as of September 30, 2010 and December 31, 2009 (in millions):

| | September 30, 2010 | December 31, 2009 |
|--|-----------------------|----------------------|
| Goodwill | | |
| Equities | | |
| Purchase of Trimark business | \$ 10.1 | \$ 10.1 |
| Purchase of Tradetech business | 3.0 | 3.0 |
| Purchase of Donaldson business | 3.6 | 3.6 |
| Purchase of remaining shares in Knight Roundtable Europe | 2.5 | 2.5 |
| Purchase of Direct Trading business | 43.8 | 43.8 |
| Purchase of EdgeTrade business | 51.7 | 51.7 |
| Total | 114.7 | 114.7 |
| FICC | | |
| Purchase of Hotspot business | 55.7 | 55.7 |
| Purchase of Valubond business | 14.2 | 14.2 |
| Purchase of Libertas business ⁽¹⁾ | 114.3 | 81.0 |
| Purchase of Urban business | 17.8 | - |
| Total | 202.0 | 150.8 |
| Corporate | | |
| Other | 1.0 | - |
| Total | 1.0 | - |
| Consolidated Total | \$ 317.7 | \$ 265.5 |

(1) During the third quarter of 2010, the Company recorded a \$33.3 million increase in Knight Fixed Income goodwill as a result of achieving its second year performance target in accordance with the earn-out provisions in the acquisition documents. As a result, the Company issued \$33.3 million in Knight unregistered common stock to the sellers.

Intangible assets primarily represent client relationships and are amortized over their remaining useful lives, the majority of which have been determined to range from four to 24 years. The weighted average remaining life of the Company's intangible assets at September 30, 2010 and December 31, 2009 is approximately 10 and 11 years, respectively.

Total Intangible assets decreased by \$1.8 million during the nine months ended September 30, 2010 primarily due to amortization expense offset by the purchase of broker relationships and other intangibles associated with the acquisition of Urban in the FICC segment and a newly acquired

customer list in the Equities segment.

The Company recorded amortization expense, related to its intangible assets of \$3.5 million and \$2.7 million, for the three months ended September 30, 2010 and 2009, respectively, and \$9.0 million and \$8.1 million, for the nine months ended September 30, 2010 and 2009, respectively. The estimated amortization expense relating to the intangible assets for each of the next five years approximates \$3.4 million for the remainder of 2010, \$13.6 million in 2011, \$13.3 million in 2012, \$11.1 million in 2013 and \$9.3 million in 2014.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

The following table summarizes the Company's Intangible assets, net of accumulated amortization as of September 30, 2010 and December 31, 2009 (in millions):

| <i>Intangible Assets</i> | September 30, 2010 | December 31, 2009 |
|-----------------------------------|-------------------------------|------------------------------|
| Equities | | |
| Customer and broker relationships | \$ 18.1 | \$ 19.8 |
| Trade names | 3.5 | 3.7 |
| Other | 4.4 | 5.0 |
| Total | 26.0 | 28.6 |
| FICC | | |
| Customer and broker relationships | 42.4 | 41.9 |
| Trade names | 4.7 | 3.7 |
| Other | 3.5 | 3.6 |
| Total | 50.6 | 49.3 |
| Corporate | | |
| Other | 14.9 | 15.5 |
| Total | 14.9 | 15.5 |
| Consolidated Total | \$ 91.5 | \$ 93.3 |

| | | September 30, 2010 | December 31, 2009 |
|--|----------------------------|-------------------------------|------------------------------|
| Customer and broker relationships ⁽¹⁾ | Gross carrying amount | \$ 90.8 | \$ 85.3 |
| | Accumulated amortization | (30.2) | (23.6) |
| | Net carrying amount | 60.5 | 61.7 |
| Trade names ⁽²⁾ | Gross carrying amount | 9.8 | 8.8 |
| | Accumulated amortization | (1.6) | (1.3) |
| | Net carrying amount | 8.2 | 7.5 |
| Other ⁽³⁾ | Gross carrying amount | 29.3 | 29.0 |

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

| | | | |
|--------------|----------------------------|----------------|----------------|
| | Accumulated amortization | (6.6) | (4.8) |
| | Net carrying amount | 22.7 | 24.2 |
| Total | Gross carrying amount | 129.9 | 123.0 |
| | Accumulated amortization | (38.4) | (29.7) |
| | Net carrying amount | \$ 91.5 | \$ 93.3 |

- (1) - Customer and broker relationships primarily relate to the Donaldson, Direct Trading, Hotspot, EdgeTrade, Libertas and Urban acquisitions. The weighted average remaining life is approximately 10 years and 11 years as of September 30, 2010 and December 31, 2009, respectively. Lives may be reduced depending upon actual retention rates.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

- (2) - Trade names relate to the acquisitions of Hotspot, EdgeTrade and Urban. The weighted average remaining life is approximately 14 and 16 years as of September 30, 2010 and December 31, 2009, respectively. During the second quarter of 2010, the Libertas trade name with an unamortized cost of \$0.3 million was written off. During 2009, the Donaldson trade name with an unamortized cost of \$2.4 million was written off.
- (3) - Other includes trading rights, technology, non-compete agreements and domain name rights acquired by the Company. The weighted average remaining life is approximately eight and seven years as of September 30, 2010 and December 31, 2009, respectively.
- Totals may not add due to rounding.

8. Long-Term Debt

In March 2010, the Company issued \$375.0 million of Cash Convertible Senior Subordinated Notes (the Notes) due on March 15, 2015 in a private offering exempt from registration under the Securities Act of 1933, as amended. At the same time, the Company entered into hedge transactions effected through the purchase of options and sale of warrants designed to limit shareholder dilution up to a price of \$31.50 per share.

The Notes bear interest at a rate of 3.50% per year, payable semi-annually in arrears, on March 15 and September 15 of each year, commencing on September 15, 2010 and will mature on March 15, 2015, subject to earlier repurchase or conversion. In connection with the issuance of the Notes, the Company recognized an original issue discount of \$73.8 million which will be accreted to interest expense over the term of the Notes, resulting in an effective annual interest rate of the Notes of approximately 7.9%. The Notes, net of original issue discount are reported as Long-term debt in the Company's Consolidated Statements of Financial Condition. As of September 30, 2010 the net balance was \$308.0 million.

Prior to December 15, 2014, the Notes will be convertible into cash only upon specified events which are based upon the price of the Company's common shares and of the Notes or upon the occurrence of specified corporate events. On or after December 15, 2014, the Notes will be convertible at any time, based on an initial conversion rate of 47.9185 shares of Knight common stock per \$1,000 principal amount of Notes, which is equivalent to an initial conversion price of approximately \$20.87 or a conversion premium of approximately 32.5% over the closing sale price of \$15.75 per share of Knight common stock on the Nasdaq Global Select Market on March 15, 2010. The conversion rate and conversion price will be subject to adjustment in certain events, such as distributions of dividends or stock splits. Upon cash conversion, Knight will deliver an amount of cash calculated over the applicable observation period. Knight will not deliver its common stock (or any other securities) upon conversion under any circumstances. In addition, following certain corporate events that occur prior to the maturity date, the Company will pay a cash make-whole premium by increasing the conversion rate for a holder who elects to convert its Notes in connection with such a corporate event in certain circumstances. Subject to certain exceptions, holders may require the Company to repurchase, for cash, all or part of the Notes upon a fundamental change at a price equal to 100% of the principal amount of the Notes being repurchased plus any accrued and unpaid interest.

Concurrent with the sale of the Notes, the Company paid \$73.7 million to enter into privately negotiated cash convertible note hedge transactions (the purchased call options) with affiliates of the initial purchasers of the Notes and another financial institution (the option counterparties) that are

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

expected generally to reduce Knight's exposure to potential cash payments in excess of the principal amount of the Notes that may be required to be made by Knight upon the cash conversion of the Notes. The purchased call options cover, subject to adjustments, approximately 18 million shares of the Company's Class A common stock at a strike price of \$20.87 and are expected to reduce the Company's economic exposure to potential cash payments in the event that the market price per share of the Company's Class A common stock is greater than the conversion price of the Notes. The purchased call options were recorded as an asset within Financial instruments owned, at fair value on the Consolidated Statements of Financial Condition and are accounted for as derivative instruments under GAAP. As of September 30, 2010, the fair value of the purchased call options was \$29.8 million.

In connection with the sale of the Notes, the Company also entered into separate warrant transactions with the option counterparties whereby the Company sold to the option counterparties, for \$15.0 million, warrants (the warrants) to purchase shares of the Company's Class A common stock, subject to adjustments, at a strike price of \$31.50 per share, which represents a premium of approximately 100% over the closing price of Knight common stock on March 15, 2010. The warrants are net share settled, meaning that the Company will issue a number of shares per warrant having a value equal to the difference between the share price at each warrant expiration date and the strike price; however, at the discretion of the Company, Knight may elect to settle the warrants in cash. If the market price per share of the Company's Class A common stock exceeds the strike price of the warrants over the warrants' exercise period and the Company elects net share settlement, the warrants would have a dilutive effect on the Company's Class A common stock. The warrants may not be exercised prior to the maturity of the Notes. The warrants have been recorded as Additional paid-in capital in the Consolidated Statements of Financial Condition. The warrants also meet the criteria of derivative instruments under GAAP; however, because the warrants are indexed to the Company's Class A common stock and are recorded within Equity in the Consolidated Statements of Financial Condition, the warrants are exempt from the scope and fair value provisions of GAAP related to accounting for derivative instruments.

The requirement that the Company settle conversions of the Notes entirely in cash gives rise to a bifurcated derivative instrument under GAAP (the embedded conversion derivative). The initial valuation of the embedded conversion derivative was \$73.8 million, and was recorded as a liability within Financial instruments sold, not yet purchased, at fair value on the Consolidated Statements of Financial Condition. As of September 30, 2010, the fair value of the embedded conversion derivative was \$29.8 million.

Both the purchased call options and the embedded conversion derivative are derivative instruments and as such are marked to fair value each reporting period with any change recognized on the Consolidated Statements of Operations as Investment income and other, net. The Company expects the gain or loss associated with changes to the valuation of the purchased call options to substantially offset the gain or loss associated with changes to the valuation of the embedded conversion derivative.

In connection with the issuance of the Notes, the Company incurred issuance costs of \$8.5 million. The issuance costs are recorded within Other assets in the Consolidated Statements of Financial Condition and are amortized over the term of the Notes. The Consolidated Statements of Operations for the three and nine months ended September 30, 2010 includes \$0.4 million and \$0.9 million, respectively, in Other expense related to the amortization of the debt issuance costs and \$6.2 million and \$13.7 million, respectively, in Interest expense related to the interest on the Notes.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS **Continued**

(Unaudited)

Concurrent with the Notes offering, the Company repaid the amounts outstanding under the \$140.0 million credit agreement originally entered into on October 9, 2007. Approximately \$0.9 million of interest expense relating to the credit agreement was recorded for the three months ended September 30, 2009 and \$0.5 million and \$1.8 million for the nine months ended September 30, 2010 and 2009, respectively.

9. Comprehensive Income

Comprehensive income includes net income and changes in equity except those resulting from investments by, or distributions to, stockholders. Comprehensive income is as follows (in millions):

| | For the three months ended September 30, | |
|-----------------------------------|---|-------------|
| | 2010 | 2009 |
| Net Income | \$ 0.2 | \$ 29.2 |
| Other comprehensive income: | | |
| Cumulative translation adjustment | 2.1 | - |
| Comprehensive income | \$ 2.3 | \$ 29.2 |
| | | |
| | For the nine months ended September 30, | |
| | 2010 | 2009 |
| Net Income | \$ 82.4 | \$ 74.1 |
| Other comprehensive income: | | |
| Cumulative translation adjustment | (2.7) | - |
| Comprehensive income | \$ 79.7 | \$ 74.1 |

Totals may not add due to rounding.

10. Stock-Based Compensation

The Company previously established the Knight Capital Group, Inc. 1998 Long Term Incentive Plan, the Knight Capital Group, Inc. 1998 Nonemployee Director Stock Option Plan, the Knight Capital Group, Inc. 2003 Equity Incentive Plan, the Knight Capital Group, Inc. 2006 Equity Incentive Plan (the 2006 Plan) (collectively, the Existing Stock Plans) and the Knight Capital Group, Inc. 2009 Inducement Award Plan (the Inducement Plan). At the Company's 2010 Annual Meeting of Stockholders, the Company's stockholders approved the Knight Capital Group, Inc. 2010 Equity Incentive Plan (the 2010 Plan , collectively with the Existing Stock Plans and the Inducement Plan, the Stock Plans). As a result of the establishment of the 2010 Plan, the 2010 Plan replaced the Existing Stock Plans for future equity grants and no additional grants will be made under the Existing Stock Plans (but the terms and conditions of any outstanding equity grants under the Existing Stock Plans will not be affected). Shares remaining available for grant under the Existing Stock Plans as of the approval date of the 2010 Plan were transferred to, and made available for grant under the 2010 Plan. In addition, any shares which would have become available again under the Existing Stock Plans due to cancellation or expiration of existing grants under the Existing Stock Plans will become available for grant under the 2010 Plan.

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

The purpose of the Stock Plans is to provide long-term incentive compensation to employees and directors of the Company. The Stock Plans are administered by the Compensation Committee of the Company's Board of Directors, and allow for the grant of options, stock appreciation rights (2006 Plan,

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

2010 Plan and Inducement Plan only), restricted stock and restricted stock units (collectively, the awards), as defined by the Stock Plans. In addition to overall limitations on the aggregate number of awards that may be awarded under the Stock Plans, the Stock Plans (except for the Inducement Plan) limit the number of awards that may be granted to a single individual as well as limit the amount of options, stock appreciation rights (2006 Plan and 2010 Plan only) or shares of restricted stock or restricted stock units that may be awarded. As of September 30, 2010, the Company has not issued any stock appreciation rights.

Restricted Shares and Restricted Stock Units

Eligible employees and directors may receive restricted shares and/or restricted stock units (collectively restricted awards) as a portion of their total compensation. The substantial majority of restricted awards generally vest ratably over three years. During 2009, the Company established the Inducement Plan with 1.5 million authorized shares and granted 378,000 restricted shares as inducement awards to new employees pursuant to this plan. During the nine months ended September 30, 2010, the Company issued 197,000 restricted shares as inducement awards pursuant to this plan. These shares were issued out of treasury and vest ratably over three years. The fair value of the inducement awards are measured in the same manner as other restricted awards. The Company has also issued restricted awards that vest based upon the market price of Knight's common stock reaching a certain price for a specified period of time (Market Shares). The Company has the right to fully vest employees and directors in their restricted stock units upon retirement and in certain other circumstances. Restricted awards are otherwise canceled if employment is terminated before the end of the relevant vesting period.

The Company measures compensation cost related to restricted awards other than Market Shares based on the fair value of the Company's common stock at the date of grant, which the Stock Plans define as the average of the high and low sales price on the business day prior to the grant date. The Company determines compensation cost for Market Shares based upon the fair value of such awards at date of grant and projected median vesting periods, both of which are based on statistical simulation models. The principal assumptions utilized in valuing Market Shares and determining their median vesting periods include: 1) risk-free interest rate estimate is based on the yield of U.S. zero coupon securities with a maturity equal to the expected life of the award; 2) expected volatility estimate is based on several factors including implied volatility of market-traded options on the Company's common stock on the grant date and the historical volatility of the Company's common stock; and 3) maximum life based upon the maximum contractual life of the award. Based upon the results of this model, the weighted-average fair value and median vesting period of Market Shares granted in the first quarter of 2009 were \$9.65 per share and 1.7 years, respectively. The principal assumptions used in valuing Market Shares issued in the first quarter of 2009 were a risk-free interest rate of 2.6%, expected volatility of 40% and maximum life of four years. There were no Market Shares granted in 2010.

Table of Contents

KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued

(Unaudited)

Compensation expense relating to restricted awards, primarily recorded in Employee compensation and benefits, as well as the corresponding income tax benefit, which is recorded in Income tax expense on the Consolidated Statements of Operations are presented in the following table (in millions).

| | For the three months ended September 30, 2010 | | For the nine months ended September 30, 2010 | |
|--------------------|---|---------|--|---------|
| | 2009 | 2009 | 2009 | 2009 |
| | (In millions) | | | |
| Restricted awards | \$ 11.0 | \$ 10.9 | \$ 37.3 | \$ 34.2 |
| Income tax benefit | \$ 4.4 | \$ 4.4 | \$ 14.9 | \$ 13.7 |

The following table summarizes restricted awards activity during the nine months ended September 30, 2010 (shares and units in thousands):

| | Restricted Shares | | Restricted Stock Units | |
|-----------------------------------|---------------------|--|------------------------|--|
| | Number of Shares | Weighted- Average Grant date Fair Value | Number of Units | Weighted- Average Grant date Fair Value |
| Outstanding at January 1, 2010 | 2,186.5 | \$ 16.92 | 3,590.7 | \$ 15.60 |
| Granted | 397.0 | 15.66 | 3,588.1 | 14.34 |
| Vested | (1,142.6) | 17.12 | (734.5) | 16.88 |
| Forfeited | (220.8) | 15.76 | (157.1) | 18.29 |
| Outstanding at September 30, 2010 | 1,220.1 | \$ 16.54 | 6,287.2 | \$ 14.66 |

Totals may not add due to rounding.

There is \$69.6 million of unamortized compensation related to unvested restricted awards outstanding at September 30, 2010. The cost of these unvested restricted awards is expected to be recognized over a weighted average life of 1.6 years.

Stock Options

The Company's policy is to grant options for the purchase of shares of Class A Common Stock at not less than market value, which the Stock Plans define as the average of the high and low sales price on the business day prior to the grant date. Options generally vest ratably over a three- or four-year period and expire on the fifth or tenth anniversary of the grant date, pursuant to the terms of the applicable option award agreement. The Company has the right to fully vest employees and directors in their stock options upon retirement and in certain other circumstances. Stock options are otherwise

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

canceled if employment is terminated before the end of the relevant vesting period. The Company's policy is to issue new shares upon share option exercises by its employees and directors.

The fair value of each option granted is estimated as of its respective grant date using the Black-Scholes option-pricing model. Stock options granted have exercise prices equal to the market value of the Company's common stock at the date of grant as defined by the Stock Plans. The principal assumptions utilized in valuing options and the methodology for estimating such model inputs include: 1) risk-free interest rate estimate is based on the yield of U.S. zero coupon securities with a maturity equal to the expected life of the option; 2) expected volatility estimate is based on several factors including implied volatility of market-traded options on the Company's common stock on the grant date

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

and the historical volatility of the Company's common stock; and 3) expected option life estimate is based on internal studies of historical experience and projected exercise behavior based on different employee groups and specific option characteristics, including the effect of employee terminations. During the nine months ended September 30, 2010, the Company granted 1.2 million options to employees. Based on the results of the model, the weighted-average fair value of the stock options granted during the nine months ended September 30, 2010 and 2009 was \$4.93 and \$5.43 per option, respectively.

Compensation expense relating to stock options, all of which was recorded in Employee compensation and benefits, as well as the corresponding income tax benefit, which is recorded in Income tax expense on the Consolidated Statements of Operations are presented in the following table (in millions).

| | For the three months ended September 30, 2010 | | For the nine months ended September 30, 2009 | |
|--------------------|---|--------|--|--------|
| Options | \$ 0.5 | \$ 0.4 | \$ 2.3 | \$ 1.8 |
| Income tax benefit | \$ 0.2 | \$ 0.2 | \$ 0.9 | \$ 0.7 |

The following table summarizes stock option activity during the nine months ended September 30, 2010 (stock options in thousands):

| | Number of Stock Options | Weighted- Average Exercise Price |
|--|----------------------------|---|
| Outstanding at January 1, 2010 | 3,554.0 | \$ 13.29 |
| Granted at market value | 1,185.1 | 15.89 |
| Exercised | (131.6) | 9.99 |
| Forfeited or expired | (383.0) | 18.36 |
| Outstanding at September 30, 2010 | 4,224.5 | \$ 13.66 |
| Exercisable at September 30, 2010 | 3,042.9 | \$ 13.66 |
| Available for future grants at September 30, 2010* | 10,975.3 | |

Totals may not add due to rounding.

* Represents both options and awards available for grant

There is \$3.4 million of unrecognized compensation related to unvested stock options outstanding at September 30, 2010. The cost of these unvested awards is expected to be recognized over a weighted average life of 2.1 years.

11. Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return as well as combined state income tax returns in certain jurisdictions. In other jurisdictions, the Company files separate company income tax returns.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

The following table reconciles the U.S. federal statutory income tax rate to the Company's actual income tax rate from continuing operations:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|-------|--|-------|
| | 2010 | 2009 | 2010 | 2009 |
| U.S. federal statutory income tax rate | 35.0% | 35.0% | 35.0% | 35.0% |
| U.S. state and local income taxes, net of U.S. federal income tax effect | 6.0% | 4.2% | 4.6% | 5.4% |
| Nondeductible charges and other, net | -0.9% | -0.5% | 0.2% | 0.0% |
| Actual income tax rate | 40.1% | 38.7% | 39.8% | 40.4% |

At September 30, 2010, the Company did not have any unrecognized tax benefits.

As of September 30, 2010, the Company is subject to U.S. Federal income tax examinations for the tax years 2007 through 2009, and to non-U.S. income tax examinations for the tax years 2006 through 2009. In addition, the Company is subject to state and local income tax examinations in various jurisdictions for the tax years 2003 through 2009. The final outcome of these examinations is not yet determinable. However, the Company anticipates that adjustments to the unrecognized tax benefits, if any, will not result in a material change to the results of operations or financial condition.

It is the Company's policy to record interest and penalties associated with tax audits as a component of Income from continuing operations, net of tax. Penalties, if any, are recorded in Other expenses and interest paid or received is recorded in Interest expense or Interest, net, respectively, on the Consolidated Statements of Operations.

12. Restructuring, Writedown of Assets and Lease Loss

In the third quarter of 2010, the Company recorded a Restructuring charge of \$16.7 million related to a plan to reduce headcount in order to rationalize expenses. The charge, which consists of severance and related costs, affected all operating segments.

Writedown of assets and lease loss accrual (benefit), net was a charge of \$1.0 million and a benefit of \$10.0 million for the nine months ended September 30, 2010 and 2009, respectively. There were no writedowns or lease loss charges for the three months ended September 30, 2010 and 2009.

During the second quarter of 2010, the Company recorded a charge of \$0.3 million related to the Company's decision to discontinue the use of the Libertas trade name and a lease loss accrual of \$0.7 million relating to excess real estate capacity. During the second quarter of 2009, the Company recorded a benefit of \$13.1 million related to a reversal of a previously recognized lease loss with respect to the Company's office space in Jersey City, N.J. The Company had previously considered a portion of these premises to be excess real estate and had therefore recorded a lease loss accrual for such excess office space. Based on expected growth and future needs, in the second quarter of 2009 management made the decision to build out and occupy the excess office space and therefore recorded a benefit related to the reversal of such previously recorded lease loss.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

Also included in the nine months ended September 30, 2009 is a charge of \$2.4 million related to the Company's decision to discontinue the use of the Donaldson trade name and the writedown of \$0.7 million of capitalized software resulting from the sale of Hotspot's retail customer accounts.

13. Discontinued Operations

In the first quarter of 2009, Deephaven completed the sale of substantially all of its assets to Stark & Roth, Inc. (together with its affiliates, Stark) with Stark agreeing to assume certain limited liabilities of Deephaven. At that time, Deephaven was replaced by Stark as the investment manager, managing member and general partner for the Deephaven Funds and the Company exited the Deephaven business. As a result of this sale, Deephaven was classified as a discontinued operation.

Income (loss) from the discontinued operations, net of tax are presented in the following table (in millions).

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|----------|--|-----------|
| | 2010 | 2009 | 2010 | 2009 |
| Pre-tax Income (loss) from discontinued operations | \$ 0.2 | \$ (1.9) | \$ 0.0 | \$ (51.8) |
| Income tax (expense) benefit | (0.1) | 0.7 | (0.2) | 17.6 |
| Income (loss) from discontinued operations, net of tax | \$ 0.1 | \$ (1.3) | \$ (0.2) | \$ (34.2) |

Totals may not add due to rounding.

Assets and liabilities related to discontinued operations which are recorded in Other assets and Accrued expenses and other liabilities on the Consolidated Statements of Financial Condition are presented in the following table (in millions).

| | September 30, 2010 | December 31, 2009 |
|---|-----------------------|----------------------|
| Assets: | | |
| Cash and cash equivalents | \$ 0.9 | \$ 3.2 |
| Deferred compensation assets | 3.2 | 10.8 |
| Total assets | \$ 4.1 | \$ 14.0 |
| Liabilities: | | |
| Accrued compensation expense | \$ 2.5 | \$ 10.9 |
| Accrued expenses and other liabilities ⁽¹⁾ | 2.6 | 4.5 |

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

| | | | | |
|-------------------|----|-----|----|------|
| Total liabilities | \$ | 5.1 | \$ | 15.3 |
|-------------------|----|-----|----|------|

Totals may not add due to rounding.

- (1) Included in Accrued expenses and other liabilities is \$2.1 million and \$0.9 million at September 30, 2010 and December 31, 2009, respectively, which are payables to the Company and presented on the Consolidated Statements of Financial Condition within Other assets.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

14. Earnings Per Share

Basic earnings per common share (EPS) has been calculated by dividing net income by the weighted average shares of Class A Common Stock outstanding during each respective period. Diluted EPS reflects the potential reduction in EPS using the treasury stock method to reflect the impact of common stock equivalents if stock options were exercised and restricted awards were to vest.

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the three and nine months ended September 30, 2010 and 2009 (in millions, except per share data):

| | For the three months ended September 30, | | | |
|--|--|-------------------------|---------------------------|-------------------------|
| | 2010 | | 2009 | |
| | Numerator / net income | Denominator / shares | Numerator / net income | Denominator / shares |
| Income and shares used in basic calculations | \$ 0.2 | 90.4 | \$ 29.2 | 89.3 |
| Effect of dilutive stock based awards | - | 2.9 | - | 4.7 |
| Income and shares used in diluted calculations | \$ 0.2 | 93.3 | \$ 29.2 | 94.0 |
| Basic earnings per share | | \$ 0.00 | | \$ 0.33 |
| Diluted earnings per share | | \$ 0.00 | | \$ 0.31 |

| | For the nine months ended September 30, | | | |
|--|---|-------------------------|---------------------------|-------------------------|
| | 2010 | | 2009 | |
| | Numerator / net income | Denominator / shares | Numerator / net income | Denominator / shares |
| Income and shares used in basic calculations | \$ 82.4 | 89.8 | \$ 74.1 | 88.9 |
| Effect of dilutive stock based awards | - | 4.2 | - | 4.6 |
| Income and shares used in diluted calculations | \$ 82.4 | 94.1 | \$ 74.1 | 93.5 |
| Basic earnings per share | | \$ 0.92 | | \$ 0.83 |
| Diluted earnings per share | | \$ 0.88 | | \$ 0.79 |

The above calculations exclude options that could potentially dilute EPS in the future but were antidilutive for the periods presented. The number of such options excluded was approximately 2.5 million and 0.1 million for the three months ended September 30, 2010 and 2009, respectively, and 2.2 million and 0.7 million for the nine months ended September 30, 2010 and 2009, respectively.

15. Significant Clients

The Company considers significant clients to be those clients who account for 10% or more of the total U.S. equity dollar value traded or fixed income notional value traded by the Company. No clients accounted for more than 10% of the Company's U.S. equity dollar value traded or fixed income notional value traded during the three and nine months ended September 30, 2010 and 2009.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

16. Commitments and Contingent Liabilities

In the ordinary course of business, the nature of the Company's business subjects it to claims, lawsuits, regulatory examinations and other proceedings. The Company is subject to several of these matters at the present time. The results of these matters cannot be predicted with certainty, and the Company cannot estimate a possible range of loss for these matters at this time. There can be no assurance that these matters will not have a material adverse effect on the Company's results of operations in any future period and a material judgment could have a material adverse impact on the Company's financial condition and results of operations. However, it is the opinion of management, after consultation with legal counsel that, based on information currently available, the ultimate outcome of these matters will not have a material adverse impact on the business, financial condition or operating results of the Company although they might be material to the operating results for any particular period, depending, in part, upon operating results for that period.

The Company leases office space under noncancelable operating leases. Certain office leases contain fixed dollar-based escalation clauses. Rental expense from continuing operations under the office leases was \$4.8 million and \$3.6 million for the three months ended September 30, 2010 and 2009, respectively, and is included in Occupancy and equipment rentals on the Consolidated Statements of Operations. For the nine months ended September 30, 2010 and 2009, rental expense from continuing operations under the office leases was \$13.5 million and \$10.0 million, respectively.

The Company leases certain computer and other equipment under noncancelable operating leases and has entered into guaranteed employment contracts with certain of its employees. As of September 30, 2010, future minimum rental commitments under all noncancelable office, computer and equipment leases (Gross Lease Obligations), Sublease Income and guaranteed employment contracts longer than one year (Other Obligations) were as follows (in millions):

Lease & Contract Obligations

| | Gross Lease Obligations | Sublease Income | Net Lease Obligations | Other Obligations |
|---------------------------------------|------------------------------------|----------------------------|----------------------------------|------------------------------|
| Three months ending December 31, 2010 | \$ 4.7 | \$ 0.3 | \$ 4.4 | \$ 47.2 |
| Year ending December 31, 2011 | 22.3 | 1.2 | 21.0 | 62.0 |
| Year ending December 31, 2012 | 22.7 | 1.4 | 21.3 | 21.1 |
| Year ending December 31, 2013 | 21.1 | 1.4 | 19.7 | - |
| Year ending December 31, 2014 | 20.3 | 1.4 | 18.9 | - |
| Thereafter through August 31, 2023 | 141.0 | 4.4 | 136.6 | - |
| | \$ 232.1 | \$ 10.1 | \$ 222.0 | \$ 130.3 |

During the normal course of business, the Company collateralizes certain leases or other contractual obligations through letters of credit or segregated funds held in escrow accounts. As of September 30, 2010, the Company has provided a letter of credit for \$2.0 million, collateralized by U.S. Treasury Bills, as a guarantee for one of the Company's lease obligations. In the ordinary course of business, Knight Capital Group, Inc. also has provided, and may provide in the future, unsecured guarantees with respect to the payment obligations of certain of its trading subsidiaries including leases.

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued****(Unaudited)**

During the normal course of business, the Company may enter into futures contracts. These financial instruments are subject to varying degrees of risks whereby the fair value of the securities underlying the financial instruments, may be in excess of, or less than, the contract amount. The Company is obligated to post collateral against certain futures contracts. As of September 30, 2010 and December 31, 2009, the Company was a party to futures contracts having a notional value of \$38.2 million and \$225.5 million, respectively. The futures contracts had a fair value and unrealized gain of \$0.1 million and \$0.4 million at September 30, 2010 and December 31, 2009, respectively, and are recorded in Receivable from brokers, dealers and clearing organizations on the Consolidated Statements of Financial Condition and Net trading revenue on the Consolidated Statements of Operations.

17. Acquisition

On July 1, 2010, the Company completed the acquisition of Urban for \$28.4 million, comprising \$19.4 million in cash, approximately 350,000 shares of unregistered Knight common stock valued at \$5.0 million and a potential earnout based on future performance valued at \$4.0 million. Goodwill and intangible assets recognized upon the closing of the transaction amounted to \$24.3 million. All of the goodwill from this transaction is expected to be deductible for income tax purposes. The following table summarizes the estimated fair values of the assets acquired and liabilities assumed (in millions):

| | | |
|--|-----------|-------------|
| Agreed purchase price | \$ | 24.0 |
| Adjustment for working capital | | 4.4 |
| Purchase of business | \$ | 28.4 |
| Cash | \$ | 4.6 |
| Goodwill | | 17.8 |
| Intangible assets | | 6.5 |
| Other assets | | 6.1 |
| Accrued expenses and other liabilities | | (6.5) |
| Purchase of business | \$ | 28.4 |

Totals may not add due to rounding.

18. Business Segments

Effective the fourth quarter of 2009, the Company separated the former Global Markets segment into two operating segments: i) Equities and ii) FICC. This breakout is consistent with the organizational structure of the business. As a result of this change in segment reporting, the Company now has three operating segments within its continuing operations: Equities, FICC and Corporate. Effective March 31, 2009, Deephaven was classified as a discontinued operation.

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

The Equities segment includes electronic market-making and electronic and voice institutional sales and trading in global equities, futures and options. In the course of market-making and trading, Equities provides capital facilitation as well as a range of complementary services. The Equities segment also provides equity capital markets services. The FICC segment includes research, sales and trading in fixed income as well as electronic trading in fixed income and foreign exchange. Fixed income research publishes reports using structure valuation and data-driven analytics to provide

Table of Contents**KNIGHT CAPITAL GROUP, INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Continued**

(Unaudited)

buy-side clients with information and insight on private and public companies. FICC also provides debt capital markets services and originates home equity conversion mortgages, or reverse mortgages. The Corporate segment invests in strategic financial services-oriented opportunities, allocates, deploys and monitors all capital, and maintains all corporate overhead expenses and all other expenses that are not attributable to the Equities and FICC segments. The Company's revenues, income (loss) from continuing operations before income taxes (Pre-tax earnings) and total assets by segment are summarized in the following table (in millions):

| | Equities | FICC | Corporate | Consolidated Total |
|---|----------|----------|-----------|--------------------|
| For the three months ended September 30, 2010: | | | | |
| Revenues | \$ 176.2 | \$ 59.8 | \$ 3.5 | \$ 239.5 |
| Pre-tax earnings ⁽¹⁾ | 25.5 | (12.8) | (12.6) | 0.1 |
| Total assets ⁽²⁾ | 4,059.7 | 432.3 | 311.9 | 4,803.9 |
| For the three months ended September 30, 2009: | | | | |
| Revenues | \$ 216.9 | \$ 78.3 | \$ 4.8 | \$ 299.9 |
| Pre-tax earnings ⁽¹⁾ | 44.3 | 15.6 | (10.2) | 49.8 |
| Total assets ⁽²⁾ | 2,411.5 | 287.2 | 105.2 | 2,803.9 |
| For the nine months ended September 30, 2010: | | | | |
| Revenues ⁽³⁾ | \$ 700.6 | \$ 188.0 | \$ 1.5 | \$ 890.0 |
| Pre-tax earnings ⁽¹⁾ | 193.3 | (3.8) | (52.3) | 137.2 |
| Total assets ⁽²⁾ | 4,059.7 | 432.3 | 311.9 | 4,803.9 |
| For the nine months ended September 30, 2009: | | | | |
| Revenues | \$ 659.0 | \$ 196.4 | \$ 3.7 | \$ 859.2 |
| Pre-tax earnings ⁽¹⁾ | 170.6 | 40.6 | (29.5) | 181.7 |
| Total assets ⁽²⁾ | 2,411.5 | 287.2 | 105.2 | 2,803.9 |

Totals may not add due to roundings.

- (1) Included in Pre-tax earnings for the three and nine months ended September 30, 2010 is a Restructuring charge of \$16.7 million which is composed of \$3.1 million for Equities, \$12.9 million for FICC and \$0.7 million for Corporate.
- (2) Total assets do not include Assets within discontinued operations of \$4.1 million and \$16.6 million at September 30, 2010 and 2009, respectively.
- (3) Included in FICC revenues for the nine months ended September 30, 2010 are fees of \$2.9 million resulting from the Company acting as joint lead manager in its Note offering (see Footnote 8 Long-Term Debt). An offsetting elimination is included in Corporate revenues to eliminate this fee for consolidation purposes.

19. Subsequent Event

On October 1, 2010, the Company acquired Astor Asset Management, LLC (Astor), a money management firm specializing in macro-economic strategy and exchange-traded funds portfolio construction for approximately \$18.0 million comprising \$10.8 million in cash and approximately 579,000 shares of unregistered Knight common stock valued at \$7.2 million. The results of Astor will be included within the Equities segment beginning with the fourth quarter of 2010.

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

The following discussion of our results of operations should be read in conjunction with our consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2009 as filed with the U.S. Securities and Exchange Commission (SEC). This discussion contains forward-looking statements that involve risks and uncertainties, including those discussed in our Form 10-K. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth elsewhere in this document and in our Form 10-K.

Certain statements contained in this Quarterly Report on Form 10-Q, including, without limitation, those under Management's Discussion and Analysis of Financial Condition and Results of Operations herein (MD&A), Quantitative and Qualitative Disclosures About Market Risk in Part I, Item 3, Legal Proceedings in Part II and the documents incorporated by reference, may constitute forward-looking statements. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about the Company's industry, management's beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, readers are cautioned that any such forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict including, without limitation, risks associated with changes in market structure, legislative or regulatory rule changes, and the costs, integration, performance and operation of the businesses recently acquired or developed organically, or that may be acquired in the future, by the Company. Since such statements involve risks and uncertainties, the actual results and performance of the Company may turn out to be materially different from the results expressed or implied by such forward-looking statements. Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. Unless otherwise required by law, the Company also disclaims any obligation to update its view of any such risks or uncertainties or to announce publicly the result of any revisions to the forward looking statements made in this report. Readers should carefully review the risks and uncertainties disclosed in the Company's reports with the SEC including, without limitation, those detailed under Certain Factors Affecting Results of Operations within MD&A herein and under Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2009 and in the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2010, and in other reports or documents the Company files with, or furnishes to, the SEC from time to time. This discussion should be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto contained in this Form 10-Q, and in other reports or documents the Company files with, or furnishes to, the SEC from time to time.

Executive Overview

We are a global financial services firm that provides access and trade execution services across multiple asset classes to a broad network of clients, including buy- and sell-side firms and corporations. We seek to continually apply our expertise and innovation to the trade execution process to build lasting client relationships through consistent performance and superior client service. We also provide capital markets services to corporate issuers and private companies. We have three operating segments within our continuing operations, Equities, Fixed Income, Currencies and Commodities (FICC) and Corporate.

Equities Our Equities segment includes electronic market-making, and electronic and voice institutional sales and trading in global equities, futures and options. In the course of market-making and trading, we provide capital facilitation and a range of complementary services. Within our Equities segment, we also provide equity capital markets services.

Table of Contents

FICC Our FICC segment includes research, sales and trading in fixed income, as well as electronic trading in fixed income and foreign exchange. Fixed income research publishes reports using structure valuation and data-driven analytics to provide our buy-side clients with information and insight on private and public companies. Within our FICC segment, we also provide debt capital markets services and originate home equity conversion mortgages, or reverse mortgages.

Corporate Our Corporate segment invests in strategic financial services-oriented opportunities, allocates, deploys and monitors all capital, and maintains all corporate overhead expenses and all other expenses that are not attributable to the Equities and FICC segments. Corporate overhead expenses consist of compensation for senior executives and other employees of the corporate holding company, expenses from legal and other professional services relating to corporate matters as well as directors' fees and directors' and officers' insurance. Results of our Corporate segment includes income from investments in funds formerly managed by Deephaven Capital Management (Deephaven Funds).

The following table sets forth: (i) Revenues, (ii) Expenses and (iii) Pre-tax earnings (loss) from continuing operations of our segments and on a consolidated basis (in millions):

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|-------------------------|---|----------|--|----------|
| | 2010 | 2009 | 2010 | 2009 |
| Equities | | | | |
| Revenues | \$ 176.2 | \$ 216.9 | \$ 700.6 | \$ 659.0 |
| Expenses ⁽¹⁾ | 150.7 | 172.6 | 507.2 | 488.4 |
| Pre-tax earnings | 25.5 | 44.3 | 193.3 | 170.6 |
| FICC | | | | |
| Revenues | 59.8 | 78.3 | 188.0 | 196.4 |
| Expenses ⁽¹⁾ | 72.6 | 62.7 | 191.8 | 155.8 |
| Pre-tax (loss) earnings | (12.8) | 15.6 | (3.8) | 40.6 |
| Corporate | | | | |
| Revenues | 3.5 | 4.8 | 1.5 | 3.7 |
| Expenses ⁽¹⁾ | 16.2 | 14.9 | 53.8 | 33.2 |
| Pre-tax (loss) | (12.6) | (10.2) | (52.3) | (29.5) |
| Consolidated | | | | |
| Revenues | 239.5 | 299.9 | 890.0 | 859.2 |
| Expenses ⁽¹⁾ | 239.4 | 250.2 | 752.8 | 677.5 |
| Pre-tax earnings | \$ 0.1 | \$ 49.8 | \$ 137.2 | \$ 181.7 |

Totals may not add due to rounding.

(1) Included in Expenses for the three and nine months ended September 30, 2010 is a Restructuring charge of \$16.7 million which comprised \$3.1 million for Equities, \$12.9 million for FICC and \$0.7 million for Corporate.

Consolidated Revenues for the three months ended September 30, 2010 decreased \$60.4 million, or 20.1%, from the same period a year ago, while Consolidated Expenses decreased \$10.8 million, or 4.3%. Consolidated Pre-tax earnings from continuing operations for the three months ended September 30, 2010 decreased \$49.6 million from the same period a year ago.

Table of Contents

Consolidated Revenues for the nine months ended September 30, 2010 increased \$30.9 million, or 3.6%, from the same period a year ago, while Consolidated Expenses increased \$75.4 million, or 11.1%. Consolidated Pre-tax earnings from continuing operations for the nine months ended September 30, 2010 decreased \$44.5 million, or 24.5%, from the same period a year ago.

The changes in our Pre-tax earnings (loss) from continuing operations by segment from the three and nine months ended September 30, 2009 to the three and nine months ended September 30, 2010 are summarized as follows:

Equities Our Pre-tax earnings from Equities for the three months ended September 30, 2010 decreased by \$18.8 million, or 42.5%, from the comparable period in 2009. The decrease is primarily due to lower revenues from our market-making business, decrease in equity volumes and a \$3.1 million restructuring charge that was incurred in the third quarter of 2010. Our Pre-tax earnings from Equities for the nine months ended September 30, 2010 increased by \$22.8 million, or 13.3%, from the comparable period in 2009. The increase is primarily due to strong performance in our electronic market-making and algorithmic principal trading and higher equity dollar value traded offset, in part, by higher expenses including: increased volume-based transaction fees; additional compensation costs associated with changes in our business mix and additional headcount; our investments in businesses and infrastructure, both domestically and internationally; and the aforementioned restructuring charge.

FICC Our Pre-tax results from FICC for the three months ended September 30, 2010 decreased by \$28.4 million from the comparable period in 2009. Our Pre-tax results from FICC for the nine months ended September 30, 2010 decreased by \$44.4 million from the comparable period in 2009. The decrease is primarily due to higher total compensation cost from employee retention due to competition, a slowdown in volumes in our Knight Fixed Income business, and a \$12.9 million restructuring charge that was incurred in the third quarter of 2010 offset, in part, by higher volumes and earnings from our Hotspot and Knight BondPoint businesses.

Corporate Our Pre-tax loss from our Corporate segment for the three months ended September 30, 2010 increased by \$2.5 million from the comparable period in 2009, primarily due to higher interest expense related to our Cash Convertible Senior Subordinated Notes (Notes) issued in March 2010 and decreased returns from our corporate investments. Our Pre-tax loss from our Corporate segment for the nine months ended September 30, 2010 increased by \$22.8 million from the comparable period in 2009, primarily due to higher interest expense related to our Notes, the elimination of \$2.9 million of revenue within FICC related to the Notes offering and higher legal and consulting fees relating to new business initiatives offset, in part, by lower compensation costs and an increase in the returns from our corporate investment as a limited partner or non-managing member in the Deephaven Funds.

Certain Factors Affecting Results of Operations

We may experience significant variation in our future results of operations. These fluctuations may result from numerous factors. These factors include, among other things, market conditions and the resulting volatility and credit and counterparty risks that may result; introductions of, or enhancements to, trade execution services by us or our competitors; the value of our securities positions and other financial instruments and our ability to manage the risks attendant thereto; the volume of our trade execution activities; the dollar value of securities and other instruments traded; the composition and profile of our order flow; our market share with institutional and broker-dealer clients; the performance and size of, and volatility in, our electronic market-making and program trading portfolios; the performance of our algorithmic principal trading models; movements of credit spreads; the

Table of Contents

performance of our global operations; costs associated with our global expansion and domestic growth; the effectiveness of our self-clearing platform; our ability to manage personnel, compensation, overhead and other expenses, including our occupancy expenses under our office leases and expenses and charges relating to legal and regulatory proceedings; the strength of our client relationships; changes in payments for order flow, changes to execution quality and changes in clearing, execution and regulatory transaction costs; the addition or loss of executive management, sales, electronic and voice trading and technology professionals; legislative, legal and regulatory changes; legal and regulatory matters or proceedings; geopolitical risk; the amount, timing and cost to build out our self-clearing initiative and other capital expenditures, acquisitions and divestitures; the integration, performance and operation of acquired businesses; the incurrence of costs associated with acquisitions and dispositions; investor sentiment; technological changes and events; seasonality; competition; and market and economic conditions.

Such factors may also have an impact on our ability to achieve our strategic objectives, including, without limitation, increases in our market share, growth and profitability in our Equities and FICC segments. If demand for our services declines due to any of the above factors, and we are unable to adjust our cost structure on a timely basis, our operating results could be materially and adversely affected. As a result of the foregoing factors, period-to-period comparisons of our revenues and operating results are not necessarily meaningful and such comparisons cannot be relied upon as indicators of future performance. There also can be no assurance that we will be able to continue the rates of revenue growth that we have experienced in the past or that we will be able to improve our operating results.

Trends

Global Economic Trends

Our businesses are affected by many factors in the global financial markets and worldwide economic conditions. These factors include the growth level of gross domestic product in the U.S., Europe and Asia, and the existence of transparent, efficient and liquid equity and debt markets and the level of trading volumes.

During the quarter ended September 30, 2010, volatility levels across equity markets decreased. Overall, there are still concerns about the outlook for global growth, inflation and declining asset values.

Trends Affecting Our Company

We believe that our businesses are affected by the aforementioned global economic trends as well as more specific trends. Some of the specific trends that impact our operations, financial condition and results of operations are:

Broker-dealer clients continue to focus on statistics measuring the quality of equity executions (including speed of execution and price improvement). In an effort to improve the quality of their executions as well as increase efficiencies, market makers have increased the level of automation within their operations and the extent of price improvement. The greater focus on execution quality has resulted in greater competition in the marketplace, which, along with market structure changes and market conditions, has negatively impacted the revenue capture metrics of the Company and other market-making firms.

Equity and FICC transaction volumes executed by broker-dealers have fluctuated over the past few years due to retail and institutional investor sentiment, market conditions and a variety of other factors, resulting in a shift of product mix. Equities and FICC transaction volumes may not be sustainable and are not predictable.

Table of Contents

In recent years several exchanges have entered into joint ventures with broker-dealers to create their own alternative trading systems (ATS) and electronic communication networks (ECN) and compete within the OTC and listed trading venues. In addition, there are many new entrants into the market, including ATS, Multilateral Trading Facilities, systematic internalizers, dark liquidity pools, high frequency trading firms, and market-making firms competing for retail and institutional order flow. Further, many broker-dealers are offering their own internal crossing networks. These factors continue to create further fragmentation and competition in the marketplace.

Market structure changes, competition and market conditions have triggered an industry shift toward market makers charging explicit commissions or commission equivalents to institutional clients for executions in OTC securities. For the majority of our institutional client orders, we charge explicit fees in the form of commissions or commission equivalents. Institutional commission rates have fallen in the past few years due to competitive forces and increased electronic trading, and may continue to fall in the future.

Market structure changes, competition and technology advancements have also led to a dramatic increase in electronic message traffic. These increases in message traffic place heavy strains on the technology resources, bandwidth and capacities of market participants.

Many institutional clients allocate commissions to broker-dealers based on the quality of executions, as well as in exchange for research, or soft dollar and commission recapture programs.

There has been continued scrutiny of the capital markets industry by the regulatory and legislative authorities, both in the U.S. and abroad. New legislation or new or modified regulations and rules could occur in the future and could materially impact the Company's revenues and profitability. Members of the U.S. Congress have raised various concerns about the regulatory structure of the U.S. capital markets and have asked the SEC to take a close look at the regulatory structure and make the changes necessary to insure the rule framework governing the U.S. capital markets is comprehensive and complete. The SEC has stated that it will carefully review, and propose rules where necessary, on a variety of marketplace trading issues including, but not limited to: high frequency trading, indications of interest, various forms of off-exchange trading, dark liquidity pools, internalization, post-trade attribution, co-location, and sponsored access. In addition, the SEC has proposed rules dealing with flash orders, indications of interest, ATS thresholds, and other market-related rules (some of which have been finalized). Some of the matters being discussed and proposed, or adopted, by the SEC, national securities exchanges and/or legislative bodies include:

On January 14, 2010, the SEC published a Concept Release in which it sought public comments on a broad range of equity-related market structure issues. The SEC intends to use the public's comments to help determine whether regulatory initiatives to improve the current equity market structure are needed and, if so, the specific nature of such initiatives.

On February 26, 2010, the SEC issued a final rule amending Regulation SHO. These amendments impose restrictions on, among other things, the prices at which securities may be sold short under certain conditions. As presently constructed, the short sale proposals will make it more difficult for market makers to sell stock short under certain conditions. The effective date for the new amendments was May 10, 2010, and the compliance date is November 10, 2010.

Table of Contents

On May 26, 2010, the SEC proposed a new rule that would require self-regulatory organizations (SROs) to establish a consolidated audit trail system that would enable regulators to trade information related to trading orders received and executed across securities markets.

On June 10, 2010, the SEC approved rules that require exchanges and FINRA to pause trading in certain individual stocks (S&P 500 Index stocks) if the price moves 10 percent or more in a five-minute period. Initially, the rules will be in effect for a pilot period through December 10, 2010. On September 14, 2010, the SEC approved rules expanding the scope of the circuit breakers to include the Russell 1000 stocks.

On June 22, 2010, the SEC approved rules submitted by FINRA to establish certain regulatory protections for the market for OTC Equity Securities that are similar to those established for national market system securities by Regulation NMS including rules relating to sub-penny quoting, limit order display, locked/crossed markets and access fees.

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act was enacted into law. The Act marks a significant change to the regulation of the financial services industry. This legislation will affect nearly all financial institutions that operate in the U.S. As a result, financial institutions must now begin to deal with the historic shift in U.S. banking, securities, derivatives, executive compensation, consumer protection and corporate governance that will grow out of the general framework established by the Act. While the weight of the Act falls more heavily on large, complex financial institutions, smaller institutions will also face a more complicated and expensive regulatory framework.

On September 10, 2010, the SEC approved rules to clarify the process for breaking erroneous trades. The rules make it clearer when and at what prices trades will be broken.

On September 20, 2010, national securities exchanges proposed rules to enhance the quotation requirements for market makers.

Over the past two years, the European Commission, the Committee of European Securities Regulators (CESR), the Financial Services Authority (FSA), and others have engaged in a wholesale review of the macro- and micro-structural issues of the European equity markets. There have been a number of requests for information and calls for evidence intended to assess the impact of some of the latest developments in European equity markets as well as to assess the impact and continued effectiveness of Market in Financial Instruments Directive (MiFID). These reviews have sought information on a variety of topics, including high frequency trading, sponsored access, co-location services, fee structures, tick size regimes, and indications of interest. Any legislative or regulatory action, including, but not limited to, new laws, rules or regulations in these or other areas could, depending on their form and scope, adversely impact trading volumes and profitability.

There continues to be growth in equity electronic trading, as evidenced by increased volumes over the past few years in direct market access platforms, algorithmic and program trading, high frequency trading and ECNs and dark liquidity pools. In addition, electronic trading continues to expand to other asset classes, including options, currencies and fixed income. The expansion of electronic trading may result in the growth of innovative electronic products and competition for order flow.

Table of Contents

The macro-economic environment and market conditions have had an adverse impact on the profitability of the institutional customer base, resulting in volatile earnings and decreased volumes.

There have been increased volumes in lower-priced stocks, driven by the decline in overall stock prices. Market volume, in general, is not predictable and an increase in retail volume in stocks with lower share prices may decrease the profit potential of trading these shares and increase transaction costs.

Income Statement Items

The following section briefly describes the key components of, and drivers to, our significant revenues and expenses.

Revenues

Our revenues consist principally of Commissions and fees and Net trading revenue from our Equities and FICC segments.

Revenues on transactions for which we charge explicit commissions or commission equivalents, which include the majority of our institutional client orders, are included within Commissions and fees. Commissions and fees are primarily affected by changes in our equity, fixed income and foreign exchange transaction volumes with institutional clients, changes in commission rates and the level of our soft dollar and commission recapture activity.

Trading profits and losses on principal transactions are primarily related to our market-making activities and are included within Net trading revenue. These revenues are primarily affected by changes in the amount and mix of U.S. equity trade and share volumes, our revenue capture, dollar value of equities traded, our ability to derive trading gains by taking proprietary positions, changes in our execution standards, development of, and enhancement to, our electronic market-making models, performance of our algorithmic principal trading models that interact with street flow, volatility in the marketplace, our mix of sell- and buy-side clients, regulatory changes and evolving industry customs and practices.

Interest income, net is earned from our cash held at banks, and cash held in trading accounts at clearing brokers and from collateralized financing arrangements, such as stock borrowing. The Company's third party clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers for facilitating the settlement and financing of securities transactions. Net interest is primarily affected by interest rates, the level of cash balances held at banks and clearing brokers, our level of securities positions in which we are long compared to our securities positions in which we are short, and the extent of our collateralized financing arrangements.

Investment income and other, net primarily represents returns on our strategic investments, returns on deferred compensation investments and income earned, net of losses, related to our corporate investment as a limited partner or non-managing member in the Deephaven Funds. Such income or loss is primarily affected by the performance and activity of our strategic investments and changes in value of certain deferred compensation investments.

Table of Contents

Expenses

Employee compensation and benefits expense, our largest expense, primarily consists of salaries and wages paid to all employees and profitability-based compensation, which includes compensation paid to sales personnel, incentive compensation paid to all other employees based on our profitability and changes in value of certain deferred compensation investments. Employee compensation and benefits expense fluctuates, for the most part, based on changes in our revenues and business mix, profitability and the number of employees. Compensation for employees engaged in sales activities is determined primarily based on a percentage of their gross revenues net of certain transaction-based expenses.

Execution and clearance fees primarily represent fees paid to third party clearing brokers for clearing equities transactions, transaction fees paid to Nasdaq and other exchanges and regulatory bodies, and execution fees paid to third parties, primarily for executing trades on the New York Stock Exchange (NYSE) and other exchanges, and for executing orders through ECNs. Execution and clearance fees primarily fluctuate based on changes in equity trade and share volume, changes in execution strategies, rate of clearance fees charged by clearing brokers and rate of fees paid to ECNs, exchanges and certain regulatory bodies.

Communications and data processing expense primarily consists of costs for obtaining market data, telecommunications services and systems maintenance.

Depreciation and amortization expense results from the depreciation of fixed assets, which consist of computer hardware, furniture and fixtures, and the amortization of purchased software, capitalized software development costs, acquired intangible assets and leasehold improvements. We depreciate our fixed assets and amortize our purchased software, capitalized software development costs and acquired intangible assets on a straight-line basis over their expected useful lives. We amortize leasehold improvements on a straight-line basis over the lesser of the life of the improvement or the remaining term of the lease.

Interest expense consists primarily of costs associated with our Notes, our former credit facility and for collateralized financing arrangements such as stock lending.

Occupancy and equipment rentals consist primarily of rent and utilities related to rented premises and office equipment.

Payments for order flow primarily represent payments to broker-dealer clients, in the normal course of business, for directing to us their order flow in U.S. equities. Payments for order flow fluctuate as we modify our rates and as our percentage of clients whose policy is not to accept payments for order flow varies. Payments for order flow also fluctuate based on U.S. equity share volume, our profitability, the mix of market orders and limit orders, and customer mix.

Business development consists primarily of costs related to sales and marketing, conferences and relationship management.

Professional fees consist primarily of legal, accounting and consulting fees.

Restructuring charge consists of severance and related costs.

Table of Contents*Three Months Ended September 30, 2010 and 2009***Continuing Operations***Revenues**Equities*

| | For the three months ended September 30, | | Change | % of Change |
|---|---|-----------------|------------------|---------------|
| | 2010 | 2009 | | |
| Commissions and fees (millions) | \$ 99.1 | \$ 98.6 | \$ 0.5 | 0.5% |
| Net trading revenue (millions) | 77.7 | 119.6 | (41.8) | -35.0% |
| Interest, net (millions) | (0.8) | (1.5) | 0.7 | N/M |
| Investment income and other, net (millions) | 0.1 | 0.3 | (0.1) | N/M |
| Total Revenues from Equities (millions) | \$ 176.2 | \$ 216.9 | \$ (40.7) | -18.8% |
| Average daily U.S. equity dollar value traded (\$ billions) | 23.6 | 24.2 | (0.6) | -2.6% |
| Average daily U.S. equity trades (thousands) | 3,421.7 | 3,947.2 | (525.5) | -13.3% |
| Nasdaq and listed equity shares traded (billions) | 60.2 | 89.9 | (29.7) | -33.0% |
| OTC Bulletin Board and Pink Sheet shares traded (billions) | 422.6 | 755.5 | (332.9) | -44.1% |
| Average revenue capture per U.S. equity dollar value traded (bps) | 0.9 | 1.2 | (0.2) | -21.0% |
| Average daily Knight Direct equity shares (millions) | 143.4 | 76.0 | 67.4 | 88.6% |

Totals may not add due rounding

N/M Not meaningful

Total revenues from the Equities segment, which primarily comprises Commissions and fees and Net trading revenue from our domestic businesses, decreased 18.8% to \$176.2 million for the three months ended September 30, 2010, from \$216.9 million for the comparable period in 2009. Revenues for the three months ended September 30, 2010, were negatively impacted by market conditions, lower results from our market-making activities, decrease in equity volumes, and lower average revenue capture per U.S. equity dollar value traded offset, in part, by higher volumes at Knight Direct.

Average revenue capture per U.S. equity dollar value traded was 0.9 basis points (bps) for the third quarter of 2010, down 21.0% from the third quarter of 2009. The primary drivers for the decrease in revenue capture were heightened competition, ongoing investments in price improvement and execution quality and the change in profile and mix of our order flow. Average revenue capture per U.S. equity dollar value traded is calculated as the total of net domestic trading revenues plus U.S. institutional commissions and commission equivalents (included in Commissions and fees), less certain transaction-related regulatory fees (included in Execution and clearance fees), (collectively Domestic Equity Trading Revenues) divided by the total dollar value of the related equity transactions. Domestic Equity Trading Revenues were \$139.2 million and \$180.8 million for the three months ended September 30, 2010 and 2009, respectively. Domestic Equity Trading Revenues do not include revenues from our international and direct market access businesses.

Table of Contents*FICC*

| | For the three months ended September 30, | | Change | % of Change |
|---|---|----------------|------------------|---------------|
| | 2010 | 2009 | | |
| Commissions and fees (millions) | \$ 57.3 | \$ 78.5 | \$ (21.2) | -27.0% |
| Net trading revenue (millions) | 2.1 | 0.0 | 2.1 | N/M |
| Interest, net (millions) | 0.3 | (0.3) | 0.5 | N/M |
| Investment income and other, net (millions) | 0.1 | 0.1 | 0.1 | N/M |
| Total Revenues from FICC (millions) | \$ 59.8 | \$ 78.3 | \$ (18.5) | -23.6% |
| Average daily Hotspot FX notional dollar value traded (\$ billions) | 32.5 | 24.2 | 8.4 | 34.6% |

Totals may not add due to rounding.

N/M Not meaningful

Total revenues from the FICC segment, which primarily comprises Commissions and fees, decreased 23.6% to \$59.8 million for the three months ended September 30, 2010, from \$78.3 million for the comparable period in 2009. Revenues were negatively impacted by a slowdown in volumes and tightening of credit spreads in our Knight Fixed Income business and the intensified competition as a result of the re-emergence of large banks offset, in part, by higher volumes from our Hotspot and Knight BondPoint businesses, as well as revenues from the newly acquired Urban business.

Corporate

| | For the three months ended September 30, | | Change | % of Change |
|---|--|---------------|-----------------|---------------|
| | 2010 | 2009 | | |
| Total Revenues from Corporate (millions) | \$ 3.5 | \$ 4.8 | \$ (1.2) | -25.7% |

Total revenues from the Corporate segment decreased to \$3.5 million for the three months ended September 30, 2010, from \$4.8 million for the comparable period in 2009. Revenues primarily represent gains or losses on strategic investments, deferred compensation investments related to certain employees and directors, and from our corporate investment as a limited partner or non-managing member in the Deephaven Funds.

Expenses

Employee compensation and benefits expense decreased to \$115.7 million for the three months ended September 30, 2010, from \$139.3 million for the comparable period in 2009. As a percentage of total revenue, Employee compensation and benefits increased to 48.3% for the three months ended September 30, 2010, from 46.5% for the comparable period in 2009. The decrease on a dollar basis was primarily due to decreased performance-based incentives due to lower profitability in our Equities and FICC segments offset, in part, by increased headcount due to the growth and investments in both our domestic and international businesses. The number of full time employees increased to 1,297 at September 30, 2010, from 1,098 at September 30, 2009, primarily due to our move to self clearing, the growth and expansion in our international business and expanded product offerings, including the acquisition of Urban in July 2010, offset by a headcount reduction related to our restructuring plan in the third quarter of 2010. Employee compensation and benefits expense fluctuates, for the most part, based on changes in our business mix, revenues, profitability and the number of employees.

Edgar Filing: KNIGHT CAPITAL GROUP, INC. - Form 10-Q

Execution and clearance fees decreased 12.4% to \$44.2 million for the three months ended September 30, 2010, from \$50.4 million for the comparable period in 2009, primarily due to lower trade and share volumes. As a percentage of total revenue, Execution and clearance fees increased to 18.4% for the three months ended September 30, 2010, from 16.8% for the comparable period in 2009. Execution and clearance fees fluctuate based on changes in transaction volumes, regulatory fees and operational efficiencies and scale.

Table of Contents

Payments for order flow decreased to \$6.6 million for the three months ended September 30, 2010, from \$17.7 million for the comparable period in 2009. As a percentage of total revenue, Payments for order flow decreased to 2.8% for the three months ended September 30, 2010, from 5.9% for the comparable period in 2009. This expense decreased primarily due to lower volumes and profitability, changes in rebate arrangements with clients, competition and customer mix.

The restructuring charge of \$16.7 million for the three months ended September 30, 2010 is related to severance and related costs in connection with our plan to reduce headcount in order to rationalize expenses.

All other expenses increased by 31.6%, or \$13.5 million, to \$56.2 million for the three months ended September 30, 2010 from \$42.7 million for the comparable period in 2009. Interest expense of \$7.5 million increased primarily due to our Notes offering and our increased stock lending activity. Depreciation and amortization expense increased primarily due to fixed asset purchases and greater capitalized software development costs. Communications and data processing expense increased primarily due to higher market data and connectivity expenses related to the growth within our Equities and FICC segments. Occupancy and equipment rentals expense increased primarily due to the costs associated with leases for new office space. Professional fees increased due to higher consulting and legal expenses, which have fluctuated based on activity relating to our new business initiatives. Other expenses increased due to higher employment fees and other administrative expenses.

Our effective tax rates from continuing operations of 40.1% and 38.7% for the three months ended September 30, 2010 and 2009, respectively, differed from the federal statutory rate of 35% primarily due to state and local income taxes and non-deductible charges.

Nine Months Ended September 30, 2010 and 2009**Continuing Operations***Revenues**Equities*

| | For the nine months ended September 30, | | Change | % of Change |
|---|---|-----------------|----------------|-------------|
| | 2010 | 2009 | | |
| Commissions and fees (millions) | \$ 310.8 | \$ 307.5 | \$ 3.3 | 1.1% |
| Net trading revenue (millions) | 390.4 | 354.6 | 35.8 | 10.1% |
| Interest, net (millions) | (0.9) | (3.6) | 2.7 | N/M |
| Investment income and other, net (millions) | 0.3 | 0.5 | (0.2) | N/M |
| Total Revenues from Equities (millions) | \$ 700.6 | \$ 659.0 | \$ 41.5 | 6.3% |
| Average daily U.S. equity dollar value traded (\$ billions) | 27.2 | 22.4 | 4.8 | 21.3% |
| Average daily U.S. equity trades (thousands) | 3,817.0 | 3,994.6 | (177.6) | -4.4% |
| Nasdaq and listed equity shares traded (billions) | 214.9 | 269.3 | (54.4) | -20.2% |
| OTC Bulletin Board and Pink Sheet shares traded (billions) | 1,658.0 | 1,462.5 | 195.5 | 13.4% |
| Average revenue capture per U.S. equity dollar value traded (bps) | 1.1 | 1.4 | (0.2) | -17.5% |
| Average daily Knight Direct equity shares (millions) | 140.0 | 63.9 | 76.1 | 119.0% |

Totals may not add due to rounding.

N/M Not meaningful

Table of Contents

Total revenues from the Equities segment, which primarily comprises Commissions and fees and Net trading revenue from our domestic businesses, increased 6.3% to \$700.6 million for the nine months ended September 30, 2010, from \$659.0 million for the comparable period in 2009. Revenues for the nine months ended September 30, 2010, were positively impacted by increased revenues from newer products and international expansion efforts, market conditions, improved results from our electronic market-making and algorithmic principal trading, higher equity dollar volumes and higher volumes at Knight Direct offset, in part, by lower average revenue capture per U.S. equity dollar value traded.

Average revenue capture per U.S. equity dollar value traded was 1.1 bps for the first nine months of 2010, down 17.5% from the comparable period in 2009. The primary drivers for the decrease in revenue capture were heightened competition, ongoing investments in price improvement and execution quality and the change in mix of our order flow. Domestic Equity Trading Revenues were \$573.0 million and \$572.7 million for the nine months ended September 30, 2010 and 2009, respectively. Domestic Equity Trading Revenues do not include revenues from our international and direct market access businesses.

FICC

| | For the nine months ended September 30, | | Change | % of Change |
|---|---|-----------------|-----------------|--------------|
| | 2010 | 2009 | | |
| Commissions and fees (millions) | \$ 185.4 | \$ 195.8 | \$ (10.4) | -5.3% |
| Net trading revenue (millions) | 2.4 | (0.1) | 2.5 | N/M |
| Interest, net (millions) | (0.4) | (0.5) | 0.1 | N/M |
| Investment income and other, net (millions) | 0.5 | 1.2 | (0.7) | N/M |
| Total Revenues from FICC (millions) | \$ 188.0 | \$ 196.4 | \$ (8.5) | -4.3% |
| Average daily Hotspot FX notional dollar value traded (\$ billions) | 35.1 | 20.3 | 14.8 | 72.9% |

Totals may not add due to rounding.

N/M Not meaningful

Total revenues from the FICC segment, which primarily comprises Commissions and fees, decreased 4.3% to \$188.0 million for the nine months ended September 30, 2010, from \$196.4 million for the comparable period in 2009. Revenues were negatively impacted by a slowdown in volumes and tightening of credit spreads in our Knight Fixed Income business and intensified competition as a result of the re-emergence of large banks, offset by higher volumes from our Hotspot and Knight BondPoint businesses, revenues from the newly acquired Urban business and a \$2.9 million intercompany fee relating to the placement of the Notes offering during the first quarter of 2010. Excluding the intercompany fee received from our Notes offering, total revenues decreased 5.8% to \$185.0 million for the nine months ended September 30, 2010.

Corporate

| | For the nine months ended September 30, | | Change | % of Change |
|---|---|---------------|-----------------|---------------|
| | 2010 | 2009 | | |
| Total Revenues from Corporate (millions) | \$ 1.5 | \$ 3.7 | \$ (2.2) | -59.5% |

Total revenues from the Corporate segment, which primarily represent gains or losses on strategic investments, deferred compensation investments related to certain employees and directors, and from our corporate investment as a limited partner or non-managing member in the Deephaven Funds,

Table of Contents

decreased to \$1.5 million for the nine months ended September 30, 2010, from \$3.7 million for the comparable period in 2009. During the first quarter of 2010, Corporate paid a \$2.9 million fee to the FICC segment with respect to the offering of our Notes. This fee was eliminated in consolidation.

Expenses

Employee compensation and benefits expense increased to \$412.8 million for the nine months ended September 30, 2010, from \$384.1 million for the comparable period in 2009. As a percentage of total revenue, Employee compensation and benefits increased to 46.4% for the nine months ended September 30, 2010, from 44.7% for the comparable period in 2009. The increase on a dollar basis was primarily due to higher compensation accruals due to improved results from our Equities segment, increased headcount due to the growth and investments in both our domestic and international businesses, and increased compensation expense at Knight Fixed Income due to hiring and retention costs. The number of full time employees increased to 1,297 at September 30, 2010, from 1,098 at September 30, 2009, primarily due to our move to self clearing, the growth and expansion in our international business and expanded product offerings, including the acquisition of Urban in July 2010, offset, in part, by a headcount reduction related to our restructuring plan in the third quarter of 2010. Employee compensation and benefits expense fluctuates, for the most part, based on changes in our business mix, revenues, profitability and the number of employees.

Execution and clearance fees increased 10.0% to \$134.2 million for the nine months ended September 30, 2010, from \$122.0 million for the comparable period in 2009, primarily due to greater volumes. As a percentage of total revenue, Execution and clearance fees increased to 15.1% for the nine months ended September 30, 2010, from 14.2% for the comparable period in 2009. Execution and clearance fees fluctuate based on changes in transaction volumes, regulatory fees and operational efficiencies and scale.

Payments for order flow decreased to \$28.7 million for the nine months ended September 30, 2010, from \$57.8 million for the comparable period in 2009. As a percentage of total revenue, Payments for order flow decreased to 3.2% for the nine months ended September 30, 2010, from 6.7% for the comparable period in 2009. This expense decreased primarily due to changes in rebate arrangements with clients, competition and customer mix.

Writedown of assets and lease loss accrual (benefit), net was \$1.0 million for the nine months ended September 30, 2010 comprising \$0.3 million for the discontinued use of the Libertas trade name and a lease loss accrual of \$0.7 million relating to excess real estate capacity. Writedown of assets and lease loss accrual (benefit), net was a benefit of \$10.0 million for the nine months ended September 30, 2009, primarily due to a lease loss reversal taken with respect to our office space in Jersey City, N.J. The Company had previously considered a portion of these premises to be excess real estate and had therefore recorded a lease loss accrual for such excess office space. Based on expected growth and future needs, in the second quarter of 2009 management made the decision to build out and occupy the excess office space and therefore recorded a benefit related to the reversal of such previously recorded lease loss. Also included in Writedown of assets and lease loss accrual (benefit), net is a charge of \$2.4 million for the nine months ended September 30, 2009, which relates to our decision to discontinue the use of the Donaldson trade name and \$0.7 million which related to the writedown of capitalized software resulting from the sale of Hotspot's retail customer accounts.

The restructuring charge of \$16.7 million for the nine months ended September 30, 2010 is related to severance and related costs in connection with our plan to reduce headcount in order to rationalize expenses.

Table of Contents

All other expenses increased by 29.0%, or \$35.9 million, to \$159.4 million for the nine months ended September 30, 2010 from \$123.6 million for the comparable period in 2009. Interest expense of \$17.1 million increased primarily due to our Notes offering and our increased stock lending activity. Communications and data processing expense increased primarily due to higher market data and connectivity expenses related to the growth within our Equities and FICC segments. Depreciation and amortization expense increased primarily due to fixed asset purchases and greater capitalized software development costs. Occupancy and equipment rentals expense increased primarily due to the costs associated with new office space leases. Professional fees increased due to higher consulting and legal expenses, which have fluctuated based on activity relating to our new business initiatives. Other expenses increased due to higher employment fees and other administrative expenses.

Our effective tax rates from continuing operations of 39.8% and 40.4% for the nine months ended September 30, 2010 and 2009, respectively, differed from the federal statutory rate of 35% primarily due to state and local income taxes and non-deductible charges.

Discontinued Operations

Deephaven Capital Management LLC and its subsidiaries (collectively, Deephaven), was formerly the registered investment adviser to, and sponsor of, the Deephaven Funds.

During the first quarter of 2009, Deephaven completed the sale of substantially all of its assets to Stark & Roth, Inc. (together with its affiliates, Stark) with Stark agreeing to assume certain limited liabilities of Deephaven. As of that date, Deephaven was replaced by Stark as the investment manager, managing member and general partner for the Deephaven Funds and we exited the Deephaven business. As a result of this sale, Deephaven was classified as a discontinued operation.

Income (loss) from discontinued operations, net of tax, was income of \$0.1 million and a loss of \$1.3 million for the three months ended September 30, 2010 and 2009, respectively, and a loss of \$0.2 million and a loss of \$34.2 million for the nine months ended September 30, 2010 and 2009, respectively. See Footnote 13 Discontinued Operations, included in Part I, Item 1 Financial Statements of this Form 10-Q for further information.

Subsequent Event

On October 1, 2010, we acquired Astor Asset Management, LLC (Astor), a money management firm specializing in macro-economic strategy and exchange-traded funds portfolio construction for approximately \$18.0 million comprising \$10.8 million in cash and approximately 579,000 shares of unregistered Knight common stock valued at \$7.2 million. The results of Astor will be included within the Equities segment beginning with the fourth quarter of 2010.

Financial Condition, Liquidity and Capital Resources

Financial Condition

We have historically maintained a highly liquid balance sheet, with a substantial portion of our total assets consisting of cash, highly liquid marketable securities and short term receivables. As of September 30, 2010, we had \$4.81 billion in assets, 82.5% of which consisted of cash or assets readily convertible into cash, principally receivables from brokers and dealers, financial instruments owned and securities borrowed. Receivables from brokers, dealers and clearing organizations include interest bearing cash balances held with third party clearing brokers, including, or net of, amounts related to securities transactions that have not yet reached their contracted settlement date, which is generally within three business days of the trade date. Financial instruments owned principally consist of equity

Table of Contents

securities that trade on the NYSE, NYSE Amex Equities and NYSE Arca markets, Nasdaq and on the OTC Bulletin Board. Securities borrowed represents the value of cash or other collateral deposited with stock lenders to facilitate the trade settlement process.

Other assets primarily represent net deferred tax assets, deposits, receivable from discontinued operations and other miscellaneous receivables.

Total assets increased \$1.79 billion, or 59.5%, from \$3.01 billion at December 31, 2009 to \$4.81 billion at September 30, 2010. The majority of the increase in assets relates to the growth of our trading book and stock borrow and loan activity relating to our self-clearing initiative. Securities borrowed increased by \$1.25 billion, from \$394.4 million at December 31, 2009 to \$1.64 billion at September 30, 2010, due to increased internal financing as we continue to migrate towards self-clearing and an increase in the matched-book activity within our self-clearing entity. Financial instruments owned increased by \$431.8 million, or 46.6%, from \$926.6 million at December 31, 2009, to \$1.36 billion at September 30, 2010, due to an increase in the size of the securities inventory utilized in our market-making, algorithmic principal trading activities and trade execution services, and the purchased call options relating to our Notes offering. Our securities inventory fluctuates based on trading volumes, market conditions, trading strategies utilized and our pre-determined risk limits.

Total liabilities increased \$1.66 billion, or 92.3%, from \$1.80 billion at December 31, 2009 to \$3.46 billion at September 30, 2010. The majority of the increase in liabilities relates to increases in Financial instruments sold, not yet purchased, Securities loaned, Long-term debt and Payable to brokers, dealers and clearing organizations offset, in part, by a decrease in our credit facility and Accrued compensation expense. Financial instruments sold, not yet purchased increased by \$522.0 million, or 81.7%, from \$639.3 million at December 31, 2009, to \$1.16 billion at September 30, 2010, due to an increase in the size of the securities inventory utilized in our market-making, algorithmic principal trading activities and trade execution services as well as the embedded conversion derivative associated with our Notes offering. Our securities inventory fluctuates based on trading volumes, market conditions, trading strategies utilized and our pre-determined risk limits and is consistent with the increase in our long securities position. Securities loaned increased by \$480.5 million, or 87.3%, from \$550.2 million at December 31, 2009, to \$1.03 billion at September 30, 2010 due to increased lending activity to facilitate short transaction settlements as we continue to migrate towards self-clearing and an increase in the matched-book activity within our self-clearing entity. Long-term debt increased to \$308.0 million at September 30, 2010 due to the offering of our Notes in March 2010. A portion of the proceeds of the Notes were used to repay our \$140.0 million credit facility (the Prior Credit Facility).

Stockholders' equity, excluding Noncontrolling interests, increased by \$132.7 million, from \$1.21 billion at December 31, 2009 to \$1.35 billion at September 30, 2010. The increase in stockholders' equity from December 31, 2009 was primarily a result of earnings, issuance of shares related to business purchases and stock-based awards activity during the nine months ended September 30, 2010.

Liquidity and Capital Resources

We have financed our business primarily through cash generated by operations, the proceeds from our stock issuances and our Notes offering of \$375.0 million. At September 30, 2010, we had net current assets, which consist of net assets readily convertible into cash less current liabilities, of \$812.7 million.

Table of Contents

We have previously disclosed our intent to pursue selective acquisitions of (or possible joint ventures with) complementary businesses primarily in the markets in which our Equities and FICC segments operate. We expect to fund the purchase price of any such acquisition with our current cash position or, in some cases, through the issuance of our stock or debt.

We have acquired several businesses over the last few years. In July 2010, we completed the acquisition of Urban for \$28.4 million, comprising \$19.4 million in cash, a potential earnout on future performance valued at \$4.0 million and approximately 350,000 shares of unregistered Knight common stock valued at \$5.0 million. In July 2008, we completed the acquisition of Knight Fixed Income's business for \$75.3 million, comprising \$50.3 million in cash and approximately 1.5 million shares of unregistered Knight common stock valued at \$25.0 million. The terms of the transaction include a potential earn-out of up to \$75.0 million of unregistered Knight common stock based on the future performance of Knight Fixed Income during the three-year period following the closing of the transaction. Knight Fixed Income has achieved both its first year and second year performance targets which entitled the sellers to receive a total of approximately \$66.6 million of the aforementioned earn-out in the form of unregistered shares of Knight common stock.

Income from continuing operations before income taxes was \$0.1 million and \$49.8 million for the three months ended September 30, 2010 and 2009, respectively. Included in these amounts were certain non-cash expenses such as stock-based compensation, depreciation, amortization and certain non-cash writedowns. Stock-based compensation was \$11.5 million and \$11.3 million for the three months ended September 30, 2010 and 2009, respectively. Depreciation expense was \$3.5 million and \$2.8 million for the three months ended September 30, 2010 and 2009, respectively. Amortization expense, which related to software, software development costs, intangible assets and leasehold improvements, was \$7.8 million and \$6.0 million for the three months ended September 30, 2010 and 2009, respectively. There were no non-cash writedowns of assets and no lease loss accruals for the three months ended September 30, 2010 and 2009.

Capital expenditures related to our continuing operations were \$18.9 million and \$12.4 million during the three months ended September 30, 2010 and 2009, respectively. Cash payment relating to purchase of a business, net of cash acquired for the three months ended September 30, 2010 was \$14.8 million. There were no cash payments relating to any purchase of a business for the three months ended September 30, 2009. Distributions from investments were \$3.1 million and \$43.1 million for the three months ended September 30, 2010 and 2009, respectively. Purchases of investments were \$2.5 million and \$3.8 million for the three months ended September 30, 2010 and 2009, respectively.

In March 2010, we issued \$375.0 million of Notes in a private offering. Net proceeds from the offering were \$167.5 million, which included \$15.0 million from the sale of warrants, less \$140.5 million for the required repayment of the Prior Credit Facility and accrued interest, \$73.7 million for the purchase of call options and \$8.5 million of offering expenses. The Notes bear interest at a rate of 3.5% per year, payable semi-annually in arrears, on March 15 and September 15 of each year, commencing on September 15, 2010 and will mature on March 15, 2015, subject to earlier repurchase or conversion. For the three months ended September 30, 2010, we recognized interest expense related to the Notes of \$6.2 million. See Footnote 8 Long-Term Debt, included in Part I, Item 1 Financial Statements of this Form 10-Q for further information.

We have an authorized stock repurchase program of \$1 billion. During the third quarter of 2010, we repurchased 1,000,000 shares for approximately \$12.8 million under the stock repurchase program. Through September 30, 2010, we repurchased 70.7 million shares for \$804.0 million under this program. We may repurchase shares from time to time in open market transactions, accelerated stock buyback programs, tender offers, privately negotiated transactions or by other means.

Table of Contents

Repurchases may also be made under Rule 10b5-1 plans. The timing and amount of repurchase transactions will be determined by our management based on its evaluation of current and future financing needs, market conditions, share price, legal requirements and other factors. The program may be suspended, modified or discontinued at any time without prior notice. We caution that there are no assurances that any further repurchases will actually occur. We had approximately 97.6 million shares of Class A Common Stock outstanding as of September 30, 2010.

Our U.S. registered broker-dealers are subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers and require the maintenance of minimum levels of net capital, as defined in SEC Rule 15c3-1. These regulations also prohibit a broker-dealer from repaying subordinated borrowings, paying cash dividends, making loans to its parent, affiliates or employees, or otherwise entering into transactions which would result in a reduction of its total net capital to less than 120% of its required minimum capital. Moreover, broker-dealers are required to notify the SEC and FINRA prior to repaying subordinated borrowings, paying dividends and making loans to its parent, affiliates or employees, or otherwise entering into transactions, which, if executed, would result in a reduction of 30% or more of its excess net capital (net capital less minimum requirement). The SEC has the ability to prohibit or restrict such transactions if the result is detrimental to the financial integrity of the broker-dealer. As of September 30, 2010, all of our broker-dealers were in compliance with the applicable regulatory net capital rules.

The following table sets forth the net capital levels and requirements for the following significant regulated broker-dealer subsidiaries at September 30, 2010, as reported in their respective regulatory filings (in millions):

| Entity | Net Capital | Net Capital Requirement | Excess Net Capital |
|---------------------|-------------|-------------------------|--------------------|
| KEM | \$ 74.3 | \$ 1.0 | \$ 73.3 |
| KCM | 52.5 | 1.0 | 51.5 |
| KCS | 50.2 | 0.8 | 49.4 |
| Knight Fixed Income | 22.1 | 3.2 | 18.9 |
| Knight Direct | 18.7 | 0.3 | 18.4 |

Our foreign registered broker-dealers are subject to certain financial resource requirements of either the FSA or the SFC. The following table sets forth the financial resource requirement for the following significant foreign regulated broker-dealer at September 30, 2010 (in millions):

| Entity | Financial Resources | Resource Requirement | Excess Financial Resources |
|--------|---------------------|----------------------|----------------------------|
| KCEL | \$ 103.4 | \$ 29.2 | \$ 74.2 |

Off-Balance Sheet Arrangements

As of September 30, 2010, we did not have any off-balance sheet arrangements, as defined in Item 303(a) (4) (ii) of SEC Regulation S-K.

Effects of Inflation

Because the majority of the Company's assets are liquid in nature, they are not significantly affected by inflation. However, the rate of inflation may affect the Company's expenses, such as employee compensation, office leasing costs and communications expenses, which may not be readily recoverable in the prices of the services offered by the Company. To the extent inflation results in rising interest rates and has other adverse effects on the securities markets, it may adversely affect the Company's financial position and results of operations.

Table of Contents

Critical Accounting Policies

Our Consolidated Financial Statements are based on the application of GAAP which requires us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates and any such differences may be material to our Consolidated Financial Statements. We believe that the estimates set forth below may involve a higher degree of judgment and complexity in their application than our other accounting estimates and represent the critical accounting estimates used in the preparation of our consolidated financial statements. We believe our judgments related to these accounting estimates are appropriate. However, if different assumptions or conditions were to prevail, the results could be materially different from the amounts recorded.

Financial Instruments and Fair Value We value our financial instruments using a hierarchy of fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value.

The fair value hierarchy can be summarized as follows:

Level 1 Valuations based on quoted prices in active markets for identical assets or liabilities that we have the ability to access. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these products does not entail a significant degree of judgment.

Level 2 Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly.

Level 3 Valuations based on inputs that are unobservable and significant to the overall fair value measurement. Changes in fair value are recognized in earnings each period for financial instruments that are carried at fair value.

Our securities owned and securities sold, not yet purchased will generally be classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices or broker or dealer quotations with reasonable levels of price transparency.

The types of instruments that trade in markets that are not considered to be active, but are valued based on observable inputs such as quoted market prices, or alternative pricing sources with reasonable levels of price transparency are generally classified within Level 2 of the fair value hierarchy.

As discussed in Footnote 8 Long-Term Debt, included in Part I, Item 1 Financial Statements of this Form 10-Q, we entered into purchased call options and recorded an embedded conversion derivative concurrent with the issuance of the Notes. The fair value of these derivatives are determined using an option pricing model based on observable inputs such as implied volatility of our common stock, risk-free interest rate, and other factors and, as such, are classified within Level 2 of the fair value hierarchy.

As of September 30, 2010, our loans inventory, foreign currency forward contracts, investment in the Deephaven Funds, the purchased call options, the embedded conversion derivative and deferred compensation investments met the definition of Level 2.

Table of Contents

Certain instruments are classified within Level 3 of the fair value hierarchy because they trade infrequently and therefore have little or no price transparency. For those instruments that are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence. In the absence of such evidence, management's best estimate is used. As of September 30, 2010 and December 31, 2009, we did not hold any financial instruments that met the definition of Level 3.

There were no transfers of financial instruments between levels of the fair value hierarchy for any periods presented.

Market-Making, Trading and Sales Activities Financial instruments owned and Financial instruments sold, not yet purchased, which primarily consist of listed and OTC equities, are carried at fair value and are recorded on a trade date basis. Net trading revenue (trading gains, net of trading losses) and commissions (which includes commission equivalents earned on institutional client orders) and related expenses are also recorded on a trade date basis. Our third party clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers for facilitating the settlement and financing of securities transactions.

Dividend income relating to securities owned and dividend expense relating to securities sold, not yet purchased, derived from our market-making activities are included as a component of Net trading revenue on our Consolidated Statements of Operations.

Payments for order flow primarily represent payments to broker-dealer clients, in the normal course of business, for directing their order flow in U.S. equities to us.

Goodwill and Intangible Assets As a result of our acquisitions, principally the businesses operating as Knight Direct, Hotspot, Knight BondPoint, Knight Fixed Income and Urban, we have acquired goodwill and identifiable intangible assets. We determine the values and useful lives of intangible assets upon acquisition. Goodwill is the cost of acquired companies in excess of the fair value of net assets, including identifiable intangible assets, at the acquisition date. We test goodwill and the useful lives of intangible assets for impairment at least annually or when an event occurs or circumstances change that signifies the existence of impairment.

Goodwill of \$317.7 million as of September 30, 2010 is primarily related to our Equities and FICC segments. Goodwill primarily represents purchases of the businesses now operating as Knight Direct in our Equities segment and Hotspot, Knight BondPoint, Knight Fixed Income and Urban in our FICC segment. We test the goodwill in each of our operating segments for impairment at least annually by comparing the estimated fair value of each segment with its estimated net book value. We derive the fair value of each of our operating segments based on valuation techniques we believe market participants would use for each segment (observable price-to-book multiples and discounted cash flow analyses) and we derive the net book value of our operating segments by estimating the amount of shareholders' equity required to support the activities of each operating segment. As part of our test for impairment, we also consider the profitability of the applicable reporting unit as well as the overall market value of the Company, compared to the Company's book value. We performed our annual test for impairment of goodwill in the second quarter of 2010 and determined that goodwill was not impaired at that time.

Intangible assets, with definite lives are amortized over their respective lives. Substantially all intangible assets resulted from the purchases of the businesses now operating as Knight Direct, Hotspot, Knight BondPoint, Knight Fixed Income and Urban. We amortize these assets, which primarily consist of customer relationships on a straight-line basis over their useful lives, the majority of which

Table of Contents

have been determined to range from four to 24 years. We performed our annual test for impairment of intangible assets with definitive lives in the second quarter of 2010. We test amortizable intangibles for recoverability whenever events indicate that the carrying amounts may not be recoverable. During the second quarters of 2010 and 2009, we discontinued the use of the Libertas and Donaldson trade names, respectively. As such, we wrote off \$0.3 million and \$2.4 million in intangible assets related to the Libertas and Donaldson trade names, respectively. No other events occurred in 2009 or for the nine months ended September 30, 2010 that would indicate that the carrying amounts of our amortizable intangible assets may not be recoverable and we do not believe that our intangible assets were impaired as of September 30, 2010.

Investments Investments comprise strategic investments, deferred compensation investments and investment in the Deephaven Funds. Strategic investments include noncontrolling equity ownership interests and debt instruments held by us within our non-broker-dealer subsidiaries, primarily in financial services-related businesses. Strategic investments are accounted for under the equity method, at cost or at fair value. The equity method of accounting is used where we are considered to exert significant influence on the investee. Strategic investments are held at cost, less impairment if any, when we are not considered to exert significant influence on the investee. The equity method of accounting is generally used for investments in limited partnerships and limited liability companies that are held by us or any of our non-broker-dealer subsidiaries while strategic investments in corporations by such non-broker-dealers are generally held at adjusted cost. Investments in liquid investment funds, including deferred compensation investments in mutual funds, and the investment in the Deephaven Funds are accounted for at fair value.

Strategic investments are reviewed on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If we determine that an impairment loss on a strategic investment has occurred due to a decline in fair value or other market conditions, the investment is written down to its estimated net realizable value.

We have several deferred compensation plan investments related to certain employees and directors. These plans provide a return to the participants based upon the performance of various investments. In order to hedge our liability under these plans, we generally acquire the underlying investments and hold such investments until the deferred compensation liabilities are satisfied. Changes in value of such investments are recorded in Investment income and other, net, with a corresponding charge or credit to Employee compensation and benefits on the Consolidated Statements of Operations.

Lease Loss Accrual It is our policy to identify excess real estate capacity and where applicable, accrue for related future costs, net of estimated sublease income. In determining the accrual, we perform a nominal cash flow analysis for lease losses initiated prior to December 31, 2002 and we accrue costs related to the excess capacity. For lease losses initiated after December 31, 2002, our policy is to accrue future costs related to excess capacity using a discounted cash flow analysis.

Other Estimates The preparation of financial statements in conformity with GAAP requires management to make certain estimates and assumptions. In addition to the estimates that we make in connection with accounting for the items noted above, the use of estimates is also important in determining provisions for potential losses that may arise from litigation, regulatory proceedings and tax audits.

When determining stock-based employee compensation expense, we make certain estimates and assumptions relating to volatility and forfeiture rates. We estimate volatility based on several factors including implied volatility of market-traded options on our common stock on the grant date and the historical volatility of our common stock. We estimate forfeiture rates based on historical rates of forfeiture of employee stock awards.

Table of Contents

A portion of our Employee compensation and benefits expense on the Consolidated Statements of Operations represents discretionary bonuses, which are accrued for throughout the year and paid after the end of the year. Among many factors, discretionary bonus accruals are generally influenced by our overall performance and competitive industry compensation levels.

We estimate and accrue for potential losses that may arise out of litigation and regulatory proceedings to the extent that such losses are probable and can be estimated. Significant judgment is required in making these estimates and our final liabilities may ultimately be materially different. Our total liability accrued with respect to litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses based on, among other factors, the progress of each case, our experience and industry experience with similar cases and the opinions and views of internal and external legal counsel. Given the inherent difficulty of predicting the outcome of our litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, or where cases or proceedings are in the early stages, we cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred. For more information on our legal and regulatory matters, see "Legal Proceedings" in Part I, Item 3 of the Company's Annual Report on Form 10-K for the year ended December 31, 2009, Part II, Item 1 included in this Form 10-Q, and other reports or documents the Company files with, or furnishes, to the SEC from time to time.

Accounting Standards Updates

Effective January 1, 2010, we adopted two Accounting Standards Updates (ASU), which were issued by the Financial Accounting Standards Board (FASB). The first ASU requires a reporting entity to disclose separately the amounts of transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. This ASU also clarifies existing disclosure requirements related to how assets and liabilities should be grouped by class and valuation techniques used for recurring and nonrecurring fair value measurements. Certain disclosure requirements of this ASU were effective for us beginning in the first quarter of 2010, while other disclosure requirements of this ASU are effective for financial statements issued for reporting periods beginning after December 15, 2010. Since these amended principles require only additional disclosures concerning fair value measurements, adoption did not and will not affect our Consolidated Financial Statements.

The second ASU relates to the accounting for a variable interest entity (VIE). This ASU significantly changed the criteria by which an enterprise determines whether or not it must consolidate a VIE. Under the new guidance, consolidation of a VIE requires both the power to direct the activities that most significantly impact the VIE's economic performance and the obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits of the VIE that could potentially be significant to the VIE. The adoption of this ASU had no impact on our Consolidated Financial Statements.

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

Our market-making and trading activities expose our capital to significant risks. These risks include, but are not limited to, absolute and relative price movements, price volatility and changes in liquidity, over which we have virtually no control.

For working capital purposes, we invest in money market funds and government securities or maintain interest-bearing balances at banks and in our trading accounts with clearing brokers, which are classified as Cash and cash equivalents and Receivable from brokers, dealers and clearing

Table of Contents

organizations, respectively, on the Consolidated Statements of Financial Condition. These financial instruments do not have maturity dates or present a material market risk, as the balances are short-term in nature and subject to daily repricing. Our cash and cash equivalents held in foreign currencies are subject to the exposure of foreign currency fluctuations. These balances are monitored daily and are not material to our overall cash position.

In our Equities segment where we maintain securities positions, we employ proprietary position management and trading systems that provide real-time, on-line position management and inventory control. We monitor our risks by reviewing trading positions and their appropriate risk measures. We have established a system whereby transactions are monitored by senior management and an independent risk control function on a real-time basis as are individual and aggregate dollar and inventory position totals, capital allocations, and real-time profits and losses. Our management of trading positions is enhanced by our review of mark-to-market valuations and position summaries on a daily basis.

In the normal course of business, we maintain inventories of exchange-listed and OTC equity securities, listed equity options and fixed income products. The fair value of these securities at September 30, 2010 and 2009 was \$1.27 billion and \$990.5 million, respectively, in long positions and \$1.12 billion and \$737.1 million, respectively, in short positions. The potential change in fair value, using a hypothetical 10% decline in prices, is estimated to be a loss of \$15.4 million and \$25.3 million as of September 30, 2010 and 2009, respectively, due to the offset of gains in short positions against losses in long positions.

Operational Risk

Operational risk can arise from many factors ranging from routine processing errors to potentially costly incidents arising, for example, from major systems failures. We incur operational risk across all of our business activities, including revenue generating activities as well as support functions. Legal and compliance risk is included in the scope of operational risk and is discussed below under **Legal Risk**.

Primary responsibility for the management of operational risk lies with our operating segments and supporting functions. Our operating segments maintain controls designed to manage and mitigate operational risk for existing activities. As new products and business activities are developed, we identify operational risks and design controls to mitigate the identified risks.

Disaster recovery plans are in place for critical facilities related to our primary operations and resources and redundancies are built into the systems as deemed appropriate. We have also established policies, procedures and technologies to protect our systems and other assets from unauthorized access.

Legal Risk

Legal risk includes the risk of non-compliance with applicable legal and regulatory requirements and standards. Legal risk also includes contractual and commercial risk such as the risk that a counterparty's performance obligations will be unenforceable. We are generally subject to extensive regulation in the different jurisdictions in which we conduct our business (see **Government Regulation and Market Structure** in Part I, Item 1 of our Annual Report on Form 10-K for the year ended December 31, 2009). We have established procedures based on legal and regulatory requirements that are designed to foster compliance with applicable statutory and regulatory requirements. We have also established procedures that are designed to require that our policies relating to conduct, ethics and business practices are followed.

Table of Contents

Foreign Currency Risk

Our foreign currency exposure continues to evolve as we grow internationally. Our exposure to foreign currency transaction gains and losses is the result of our foreign subsidiaries being denominated in currencies other than the U.S. dollar, primarily the British pound, the Euro and the Hong Kong dollar, in which our revenues and profits are denominated. A portion of these risks are hedged, but fluctuations in currency exchange rates could impact our results of operations, financial position and cash flows.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Company's management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Table of Contents

PART II OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we and certain of our past and present officers, directors and employees have been named as parties to legal actions, arbitrations, administrative claims and regulatory reviews and investigations arising in connection with the conduct of our businesses. We are subject to such matters at the present time. Although there can be no assurances, at this time the Company believes, based on information currently available, that the outcome of each of the matters will not have a material adverse effect on the consolidated financial condition of the Company, although they might be material to operating results for any particular period, depending, in part, upon operating results for that period.

In the third quarter of 2010, the following development occurred in the *Last Atlantis Capital LLC et al. v. Chicago Board Options Exchange, Inc. et al.* action described in the Company's Form 10-K for the year ended December 31, 2009 and updated in the Company's Form 10-Q filings subsequent to such date:

On July 21, 2010, all plaintiffs moved for reconsideration of the court's March 26, 2010 summary judgment ruling which dismissed the complaint against Knight. That motion has been fully briefed but not yet decided by the court. Also, because the case is continuing against other defendants and thus has not been fully resolved, the order dismissing the complaint against Knight has not yet become final and appealable.

Regulatory

We own subsidiaries including regulated entities that are subject to extensive oversight under federal, state and applicable international laws as well as SRO rules. Changes in market structure and the need to remain competitive require constant changes to our systems and order handling procedures. We make these changes while continuously endeavoring to comply with many complex laws and rules. Compliance, surveillance and trading issues common in the securities industry are monitored by, reported to, and/or reviewed in the ordinary course of business by our primary regulators, the SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, and NFA. As a major order flow execution destination, we are named from time to time in, or are asked to respond to a number of regulatory matters brought by U.S. regulators, foreign regulators and SROs that arise from our trading activity. The Company is currently the subject of various regulatory reviews and investigations. In some instances, these matters may rise to a SEC, CFTC, FSA, SFC, FINRA, NYSE, MSRB, NFA, other SRO disciplinary action and/or civil or administrative action.

For further information on Legal Proceedings, see the section entitled "Legal Proceedings", in Part I, Item 3 of our Annual Report on Form 10-K for the year ended December 31, 2009, and other reports or documents the Company files with, or furnishes, to the SEC from time to time.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2009 and in Part II, Item 1A. "Risk Factors" in our Quarterly Report on Form 10-Q for the quarter ended March 31, 2010, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K and Quarterly Report on Form 10-Q are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

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

The following table contains information about our purchases of our Class A Common Stock during the third quarter of 2010 (in thousands, except per share amounts):

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs ⁽¹⁾ | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs |
|---|----------------------------------|------------------------------|---|--|
| July 1, 2010 - July 31, 2010 | | | | |
| Common stock repurchases | 68 | | 68 | \$ 207,767 |
| Employee transactions ⁽²⁾ | 18 | | - | |
| Total | 85 | \$ 14.41 | 68 | |
| August 1, 2010 - August 31, 2010 | | | | |
| Common stock repurchases | 700 | | 700 | \$ 198,898 |
| Employee transactions ⁽²⁾ | 14 | | - | |
| Total | 714 | \$ 12.70 | 700 | |
| September 1, 2010 - September 30, 2010 | | | | |
| Common stock repurchases | 232 | | 232 | \$ 196,002 |
| Employee transactions ⁽²⁾ | 8 | | - | |
| Total | 240 | \$ 12.47 | 232 | |
| Total | | | | |
| Common stock repurchases | 1,000 | | 1,000 | |
| Employee transactions ⁽²⁾ | 39 | | - | |
| Total | 1,039 | \$ 12.71 | 1,000 | |

Totals may not add due to rounding.

- (1) On April 4, 2002, the Company's Board of Directors announced the authorization of a stock repurchase program, which allowed for the purchase of Class A Common Stock up to a total amount of \$35 million. This repurchase program was increased by an aggregate of \$965 million to a total of \$1 billion by resolutions of the Company's Board of Directors adopted on July 16, 2002, May 12, 2003, April 20, 2004, August 8, 2004, April 19, 2005, October 18, 2005, April 18, 2006 and July 17, 2007. The Company may repurchase shares from time to time in the open market, accelerated stock buyback programs, tender offers, privately negotiated transactions or by other means. Repurchases may also be made under a Rule 10b5-1 plan. The timing and amount of repurchase transactions will be determined by the Company's management based on its evaluation of current and future financing needs, market conditions, share price, legal requirements and other factors. The program may be suspended, modified or discontinued at any time without prior notice. The Company cautions that there are no assurances that any further repurchases will actually occur. The repurchase program has no set expiration or termination date.
- (2) Represents shares of common stock withheld in satisfaction of tax withholding obligations upon vesting of restricted stock.

Table of Contents

Item 3. Defaults Upon Senior Securities
None.

Item 5. Other Information
None.

Item 6. Exhibits

| Exhibit No. | Exhibit |
|--------------------|---|
| 31.1* | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2* | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1* | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2* | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101** | The following materials from Knight Capital Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2010, formatted in XBRL (eXtensible Business Reporting Language); (i) Consolidated Statements of Operations for the three and nine months ended September 30, 2010 and 2009, (ii) Consolidated Statements of Financial Condition at September 30, 2010 and December 31, 2009, (iii) Consolidated Statements of Cash Flows for the nine months ended September 30, 2010 and 2009 and (iv) Notes to Consolidated Financial Statements |

* Filed herewith.

** Pursuant to rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

Table of Contents

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, in the City of Jersey City, State of New Jersey, on this 9th day of November, 2010.

KNIGHT CAPITAL GROUP, INC.

By: /s/ THOMAS M. JOYCE

Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

By: /s/ STEVEN BISGAY

Chief Financial Officer
(Principal Financial and Accounting Officer)