

KNIGHT CAPITAL GROUP, INC.
Form 10-Q/A
May 10, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q/A

(AMENDMENT NO. 1)

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2013

OR

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

001-14223

Commission File Number

KNIGHT CAPITAL GROUP, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

22-3689303

(I.R.S. Employer Identification Number)

545 Washington Boulevard, Jersey City, NJ 07310

(Address of principal executive offices and zip code)

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange on which registered

Class A Common Stock, \$0.01 par value

New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

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 May 3, 2013, the number of shares outstanding of the Registrant's Class A Common Stock was 374,779,671 and there were no shares outstanding of the Registrant's Class B Common Stock or Series A-1 Cumulative Perpetual Convertible Preferred Stock.

EXPLANATORY NOTE

We are filing this Amendment No. 1 on Form 10-Q/A (the “Amendment”) to the Knight Capital Group, Inc. (the “Company”) Quarterly Report on Form 10-Q for the quarter ended March 31, 2013, as filed with the Securities and Exchange Commission on May 9, 2013 (the “Original Filing”), solely to correct typographical errors contained in Item 2 of Part I (Management's Discussion and Analysis of Financial Condition and Results of Operations - Comparison of the Three Months Ended March 31, 2013 and 2012). In the tables disclosing the comparison of the three months ended March 31, 2013 and 2012, the parenthetical description of Revenues for all operating segments should have been thousands instead of millions as presented. This Form 10-Q/A corrects those inadvertent typographical errors. Except as described above, no other changes have been made to the Original Filing, and this Amendment does not otherwise amend, update or change the financial statements or disclosures in the Original Filing.

KNIGHT CAPITAL GROUP, INC.
FORM 10-Q/A QUARTERLY REPORT
For the Quarter Ended March 31, 2013
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PART I FINANCIAL INFORMATION

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 audited Consolidated Financial Statements and notes for the year ended December 31, 2012 included in our Form 10-K/A 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/A for the year ended December 31, 2012 and our Quarterly Report on Form 10-Q/A herein. 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/A for the year ended December 31, 2012.

Certain statements contained in this Quarterly Report on Form 10-Q/A, 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" and "Risk Factors" in Part II and the documents incorporated by reference herein and statements containing the words "believes," "intends," "expects," "anticipates," and words of similar meaning, may constitute forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements are not historical facts and are based on current expectations, estimates and projections about Knight Capital Group, Inc.'s (the "Company" or "Knight") 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: (i) the pending strategic business combination of Knight and GETCO Holding Company, LLC ("GETCO") (the "Merger"); (ii) the August 1, 2012 technology issue that resulted in the Company's broker-dealer subsidiary, Knight Capital Americas LLC, sending numerous erroneous orders in NYSE-listed and NYSE Arca securities into the market and the impact to the Company's capital structure and business as well as actions taken in response thereto and consequences thereof; (iii) the sale of the Company's institutional fixed income sales and trading business; (iv) the Company's ability to recover all or a portion of the damages that are attributable to the manner in which NASDAQ OMX handled the Facebook IPO; (v) changes in market structure, legislative, regulatory or financial reporting rules; (vi) past or future changes to the Company's organizational structure and management; and (vii) the costs, integration, performance and operation of businesses previously acquired or developed organically, or that may be acquired or developed organically in the future. 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 herein.

Readers should carefully review the risks and uncertainties disclosed in the Company's reports with the SEC, including those detailed under "Certain Factors Affecting Results of Operations" in MD&A herein and under "Risk Factors" herein and in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2012 and in other reports or documents the Company or the new Knight/GETCO holding company (KCG Holdings, Inc.) files with, or furnishes to, the SEC from time to time. This information should also be read in conjunction with the Company's Consolidated Financial Statements and the Notes thereto contained in this Form 10-Q filed on May 9th, 2013, and in other reports or documents the Company files with, or furnishes to, the SEC from time to time.

In addition to factors previously disclosed in the Company's reports filed with the SEC and those identified elsewhere in our Annual Report on Form 10-K, the following factors related to the Merger, among others, could cause actual results to differ materially from forward-looking statements or historical performance: ability to obtain regulatory approvals and meet other closing conditions to the Merger, including approval by Knight and GETCO stockholders, on the expected terms and schedule; delay in closing the Merger; difficulties and delays in integrating the Knight and GETCO businesses or fully realizing cost savings and revenue opportunities; business disruption following the Merger; the inability to sustain revenue and earnings growth; and customer and client actions.

Executive Overview

We are a global financial services firm that provides access to the capital markets across multiple asset classes to a broad network of clients, including broker dealers, institutions and corporations. We seek to continually apply our

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expertise and innovation to the market making and trading process to build lasting client relationships through consistent performance and superior client service.

On December 19, 2012, Knight, GETCO Holding Company, LLC (“GETCO”) and an affiliate of GETCO entered into an agreement and plan of merger, which was subsequently amended and restated on April 15, 2013 to adjust the exchange ratios but not the aggregate consideration (the “Merger Agreement”) for a strategic business combination. As a result of the proposed strategic business combination (the “Merger”), Knight and GETCO will each become a wholly owned subsidiary of KCG Holdings, Inc. (formerly known as Knight Holdco, Inc.), a newly-formed Delaware corporation (“KCG”). The business of KCG will be the combined business of Knight and GETCO. The Merger is expected to be completed in mid-2013, subject to approval by our stockholders and GETCO's voting unitholders, customary regulatory approvals and satisfaction of customary closing conditions.

In the first quarter of 2013, the Company changed its reporting segments from Market Making, Institutional Sales and Trading, Electronic Execution Services and Corporate and Other to (i) Market Making, (ii) Global Execution Services and (iii) Corporate and Other. This change was made to better reflect our client offerings, changes in our senior management, the combination of our institutional equities sales teams and how our businesses are managed. As of March 31, 2013, our operating segments comprised the following:

Market Making—Knight's Market Making segment principally consists of market making in global equities and listed domestic options. As a market maker, the Company commits capital for trade executions by offering to buy securities from, or sell securities to, institutions and broker-dealers. The Market Making segment primarily includes client, and to a lesser extent, non-client electronic market making activities in which the Company operates as a market maker in equity securities quoted and traded on the Nasdaq Stock Market, the over-the-counter (“OTC”) market for New York Stock Exchange (“NYSE”), NYSE Amex Equities (“NYSE Amex”), NYSE Arca listed securities, and several European exchanges. As a complement to electronic market making, Knight's cash trading business handles specialized orders and also transacts on the OTC Bulletin Board, marketplaces operated by the OTC Markets Group Inc. and the Alternative Investment Market (“AIM”) of the London Stock Exchange. The segment also provides trade executions as an equities Designated Market Maker (“DMM”) on the NYSE and NYSE Amex. Market Making also includes our option market making business which trades on substantially all domestic electronic exchanges.

Global Execution Services— Knight's Global Execution Services segment offers access via its electronic agency-based platforms to markets and self-directed trading in equities, options, fixed income, foreign exchange and futures. In contrast to the Market Making segment, the Global Execution Services segment generally does not act as a principal to transactions that are executed within this segment, however, it will commit capital on behalf of clients as needed, and generally earns commissions for acting as agent between the principals to the trade. Global Execution Services also includes equity sales and trading (including exchange traded funds (“ETFs”)), reverse mortgage origination and securitization and asset management. This segment also facilitates client orders through program, block, and riskless principal trades and provides capital markets services, including equity offerings as well as private placements. Additionally, the Global Execution Services segment includes the futures commission merchant (“FCM”) business, which comprises certain assets and liabilities that we acquired or assumed from the futures division of Penson Financial Services, Inc. on June 1, 2012. This business provides futures execution and clearing services on major U.S. and European futures and options exchanges for clients.

Management from time to time conducts a strategic review of our businesses and evaluates its potential value in the marketplace relative to their current and expected returns. To the extent management and our Board of Directors determine a business may return a higher value to shareholders through a divestiture, or is no longer core to our strategy, management may pursue a sale process. As of the date of this report we are exploring the sale of certain non-core and non-strategic assets, including our reverse mortgage origination and securitization business. While the process is ongoing, there is no assurance that any transaction will occur, or if a transaction is entered into, what the terms would be. Any potential transaction would be subject to the approval of our Board of Directors, and the consummation would likely be subject to customary closing conditions, including receipt of required regulatory approvals and applicable consents.

Corporate and Other— Knight's Corporate and Other segment invests in strategic financial services-oriented opportunities, allocates, deploys and monitors all capital, and maintains corporate overhead expenses and all other income and expenses that are not attributable to the other segments. The Corporate and Other

segment houses functions that support Knight's other segments such as self-clearing services, including stock lending activities.

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 thousands):

	For the three months ended March 31,	
	2013	2012 ⁽¹⁾
Market Making		
Revenues	\$ 150,729	\$ 152,166
Expenses	114,178	107,035
Pre-tax earnings	36,550	45,131
Global Execution Services		
Revenues	122,373	140,270
Expenses	111,656	116,425
Pre-tax earnings	10,717	23,845
Corporate and Other		
Revenues	12,054	10,036
Expenses	41,417	27,914
Pre-tax loss	(29,363) (17,878
Consolidated		
Revenues	285,156	302,472
Expenses	267,252	251,374
Pre-tax earnings	\$ 17,904	\$ 51,098

Totals may not add due to rounding.

(1) Prior period amounts have been recast to conform with current period segment presentation.

Consolidated revenues for the three months ended March 31, 2013 decreased \$17.3 million, or 5.7%, from the same period a year ago, while consolidated expenses increased \$15.9 million. Consolidated pre-tax earnings from continuing operations for the three months ended March 31, 2013 was \$17.9 million as compared to consolidated pre-tax earnings of \$51.1 million for the same period a year ago.

The changes in our Pre-tax earnings (loss) from continuing operations by segment from the three months ended March 31, 2012 are summarized as follows:

Market Making— Our pre-tax earnings from Market Making for the three months ended March 31, 2013 was \$36.6 million, compared to pre-tax earnings of \$45.1 million for the comparable period in 2012. The decrease in results was due to lower volumes, increases in payments for order flow and a decrease in market volumes and volatility.

Global Execution Services—Our pre-tax earnings from Global Execution Services for the three months ended March 31, 2013 was \$10.7 million, compared to pre-tax earnings of \$23.8 million from the comparable period in 2012. The decrease in results was due to a decline in client volumes from our listed derivatives and institutional sales businesses and an additional \$4.4 million in compensation costs related to workforce reductions incurred in 2013 in an effort to combine our voice and electronic sales teams offset, in part, by increased earnings from our reverse mortgage business.

Corporate and Other—Our pre-tax loss from our Corporate and Other segment of \$29.4 million for the three months ended March 31, 2013 increased by \$11.5 million from the comparable period in 2012. The increase in loss is primarily due to higher professional fees related to the announced merger and the August 1, 2012 trading loss, and additional compensation costs related to workforce reductions offset, in part, by higher gains in our strategic investments. Excluding the additional professional fees and compensation costs, the pre-tax loss from our Corporate and Other segment was \$15.8 million for the three months ended March 31, 2013.

Certain Factors Affecting Results of Operations

We may experience significant variation in our future results of operations. Fluctuations in our future performance may result from numerous factors, including, among other things, global financial market conditions and the resulting competitive, credit and counterparty risks; cyclical, seasonality and other economic conditions; the value of our securities positions and other financial instruments and our ability to manage the risks attendant thereto; the volume, notional dollar value traded and volatility levels within the core markets where our market making and trade execution businesses operate; the composition, profile and scope of our relationships with institutional and broker-dealer clients; the performance, size and volatility of our client market making portfolios; the performance, size and volatility of our non-client principal trading activities; HECMs origination and HMBS securitization volumes and spreads; the overall size of our balance sheet and capital usage; further impairment of goodwill and/or intangible assets; the performance of our global operations, trading technology and technology infrastructure; the effectiveness of our self-clearing and futures platforms and our ability to manage risk related thereto; the availability of credit and liquidity in the marketplace; our ability to prevent erroneous trade orders from being submitted due to of technology or other issues (such as occurred on August 1, 2012) and avoiding the consequences thereof; the performance, operation and connectivity to various market centers; 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; interest rate movements; the addition or loss of executive management, sales, trading and technology professionals; geopolitical, legislative, legal, regulatory and financial reporting changes specific to financial services and global trading; legal or regulatory matters and proceedings; the pending strategic business combination of the Company and GETCO and the costs and integration associated therewith; the amount, timing and cost of business divestitures/acquisitions or capital expenditures; the integration, performance and operation of acquired businesses; the incurrence of costs associated with acquisitions and dispositions; investor sentiment; and technological changes and events.

Such factors may also have an impact on our ability to achieve our strategic objectives, including, without limitation, increases in market share, growth and profitability in our three operating segments. If demand for our services declines or our performance deteriorates significantly 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 to achieve the level of revenues 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 and volatility in such markets.

During the quarter ended March 31, 2013, trade volume and volatility levels across equity markets decreased as compared to the previous quarter. Secondary trading volumes in the equity markets were down significantly from prior years. Overall, there are still concerns about global stability and 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: 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 continue to increase the level of sophistication and automation within their operations and the extent of price improvement. The continued 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 and margin metrics of the Company and other market making firms.

Market Making and Global Execution Services transaction volumes executed by clients have fluctuated over the past few years due to retail and institutional investor sentiment, market conditions and a variety of other factors. Market Making and Global Execution Services transaction volumes may not be sustainable and are not predictable.

Over the past several years exchanges have become far more competitive, and market participants have created alternative trading systems (“ATS”), ECN and other execution venues which compete within the OTC and listed trading venues. For example, on July 3, 2012, the SEC approved rules submitted by the NYSE and NYSE Amex to establish a Retail Liquidity Program (“RLP”) on a pilot basis for one year. The RLP seeks to attract retail flow to the NYSE and NYSE Amex. This new program (as well as similar programs established by other national stock exchanges) could draw market share away from the Company, and thus negatively impact our business. 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 offer their own internal crossing networks. These factors continue to create further fragmentation and competition in the marketplace.

Market structure changes, competition, market conditions and a steady increase in electronic trading have resulted in a reduction in institutional commission rates and volumes which may continue in the future. Additionally, many institutional clients allocate commissions to broker-dealers based not only on the quality of executions, but also in exchange for research, or participation in soft dollar and commission recapture programs.

There continues to be growth in electronic trading, as evidenced by increased volumes 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 and may further reduce demand for traditional institutional voice services.

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.

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. Members of the U.S. Congress continue to ask the SEC and other regulators to closely review the financial markets regulatory structure and make the changes necessary to insure the rule framework governing the U.S. financial markets is comprehensive and complete. The SEC and other regulators have adopted and will continue to propose and adopt rules where necessary, on a variety of marketplace issues – including, but not limited to: high frequency trading, indications of interest, off-exchange trading, dark liquidity pools, internalization, post-trade attribution, colocation, market access, short sales, consolidated audit trails and market volatility rules (including, circuit breakers and limit-up, limit-down rules).

We expect increases, possibly substantial, in Section 31 fees and fees imposed by other regulators. In addition, DTCC and NSCC are considering proposals which could require substantial increases in clearing margin, liquidity and collateral requirements.

The Dodd-Frank Act affects nearly all financial institutions that operate in the U.S. While the weight of the Dodd-Frank Act falls more heavily on large, complex financial institutions, smaller institutions will continue to face a more complicated and expensive regulatory framework.

Reverse mortgages can be a cost-effective way to help seniors (age 62 and older) meet their financial needs in retirement, by enabling them to tap the equity in their home. Reverse mortgages have been popular with seniors who have equity in their homes and want to supplement their income and enhance their liquidity. This popularity may continue as the Baby Boomer generation enters retirement age. However, there is no guarantee that current volumes or the referenced popularity will continue.

Over the last few years, some of the largest reverse mortgage originators exited the reverse mortgage business. Declining home values, the inability to assess borrowers’ financial health and the focus on other business lines were cited as factors contributing to their respective decisions.

The U.S. Department of Housing and Urban Development (“HUD”) has stated that foreclosure is and must remain a method of last resort for the resolution of unpaid property charges. It has also been reported that HUD is developing procedures that would allow lenders to assess a prospective borrower’s income and expenses, and possibly require homeowners to set aside money to pay for taxes and homeowners insurance. However, no formal guidelines have yet been published.

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 all of our business segments. Revenues on transactions for which we charge explicit commissions or commission equivalents, which include the majority of our institutional client orders, commissions on futures transactions, as well as the mark-to-market of securitized and unsecuritized HECM loan inventory, are included within Commissions and fees. Commissions and fees are primarily affected by changes in our equity, fixed income, futures and foreign exchange transaction volumes with institutional clients, changes in commission rates, level of volume based fees from providing liquidity to other trading venues, loan origination and securitization volume and spreads, assets under management and the level of our soft dollar and commission recapture activity.

Trading profits and losses on principal transactions primarily relate to our global market making activities and are included within Net trading revenue. These revenues are primarily affected by changes in the amount and mix of 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 market making models, performance of our non-client trading models, volatility in the marketplace, our mix of broker-dealer and institutional clients, regulatory changes and evolving industry customs and practices.

Interest, net is earned from our cash held at banks, cash held in trading accounts at third party clearing brokers and from collateralized financing arrangements, such as securities borrowing, carry interest on loans and bonds held, and interest income net of interest expense on securitized and unsecuritized HECM loan inventory. 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 third party clearing brokers including those held for customers, the level of our securities borrowing activity, our level of securities positions in which we are long compared to our securities positions in which we are short, the extent of our collateralized financing arrangements and the level of securitized and unsecuritized HECM loan inventory.

Investment income and other, net primarily represents returns on our strategic and deferred compensation investments. 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.

Expenses

Employee compensation and benefits expense, our largest expense, primarily consists of salaries and wages paid to all employees, profitability-based compensation, which includes compensation paid to sales personnel and incentive compensation paid to all other employees based on our profitability, employee benefits, and changes in value of certain deferred compensation liabilities. 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, options and fixed income transactions; transaction fees paid to Nasdaq and other exchanges, clearing organizations and regulatory bodies; execution fees paid to third parties, primarily for executing trades on the NYSE, other exchanges and ECNs; and loan processing fees. Execution and clearance fees primarily fluctuate based on changes in trade and share volume, execution strategies, rate of clearance fees charged by clearing brokers and rate of fees paid to ECNs, exchanges and certain regulatory bodies and reverse mortgage loan origination volume.

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 and options. Payments for order flow also include fees paid to third party brokers with respect to reverse mortgage wholesale loan production. Payments for order flow will 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 and option volumes, reverse mortgage loan production and channel mix, our profitability and the mix of market orders, limit orders, and customer mix. Communications and data processing expense primarily consists of costs for obtaining market data, connectivity, telecommunications services and systems maintenance.

Interest expense consists primarily of costs associated with our long-term debt and for collateralized financing arrangements such as securities lending and sale of financial instruments under our agreements to repurchase.

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

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.

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

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

Other expenses include regulatory fees, corporate insurance, employment fees, partial month interest reserves associated with our Government National Mortgage Association (“GNMA”) issuances, and general office expense.

Three Months Ended March 31, 2013 and 2012

Revenues

Market Making

	For the three months ended					
	March 31,		Change	%		
	2013	2012				
Commissions and fees (thousands)	\$17,701	\$22,366	\$(4,665))	-20.9	%
Net trading revenue (thousands)	136,317	127,091	9,226		7.3	%
Interest, net (thousands)	(3,290)) 2,707	(5,997))	N/M	
Total Revenues from Market Making (thousands)	\$150,728	\$152,165	(1,437))	-0.9	%
U.S. equity Market Making statistics:						
Average daily dollar value traded (\$ billions)	22.2	21.9	0.3		1.4	%
Average daily trades (thousands)	2,973.3	3,334.6	(361.3))	-10.8	%
Nasdaq and Listed shares traded (billions)	43.0	47.3	(4.3))	-9.1	%
FINRA OTC Bulletin Board and Other shares traded (billions)	183.1	171.2	11.9		7.0	%
Average revenue capture per U.S. equity dollar value traded (bps)	1.00	0.99	0.01		1.0	%

Totals may not add due to rounding.

N/M - Not meaningful

Total revenues from the Market Making segment, which primarily comprises Net trading revenues and Commissions and fees from our domestic businesses, decreased slightly to \$150.7 million for the three months ended March 31, 2013, from \$152.2 million for the comparable period in 2012. Revenues were negatively impacted by fewer trades which was impacted by a decrease in market volumes as well as a decrease in market volatility offset, in part, by higher revenues from our European market making and option market making businesses.

Average revenue capture per U.S. equity dollar value traded was 1.0 basis point (“bps”) for the first quarter of 2013, up 1.0% from 0.99 bps from the first quarter of 2012. Average revenue capture per U.S. equity market making

dollar value traded is calculated as the total of net domestic market making trading revenues plus volume based fees from providing liquidity to other trading venues (included in Commissions and fees), less certain transaction-related regulatory fees (included in Execution and clearance fees) (collectively “Domestic U.S. Equity Market Making Revenues”), divided by the total dollar value of the related equity transactions. Domestic U.S. Equity Market Making Revenues were \$133.3 million and \$134.6 million for the three months ended March 31, 2013 and 2012, respectively.

	For the three months ended			
	March 31,			
	2013	2012	Change	% of Change
Commissions and fees (thousands)	\$ 107,524	\$ 118,898	\$(11,374)	-9.6 %
Net trading revenue (thousands)	12,591	26,065	(13,474)	-51.7 %
Other revenues (thousands)	2,259	(4,693)	6,952	N/M
Total Revenues from Global Execution Services (thousands)	\$ 122,373	\$ 140,270	(17,897)	-12.8 %
Average daily Knight Direct equity shares (millions)	184.6	182.7	1.9	1.0 %
Average daily Knight Hotspot FX notional dollar value traded (\$ billions)*	27.8	27.8	—	—

Totals may not add due to rounding.

* In the second quarter of 2012, Knight modified the reporting of Knight Hotspot FX notional dollar value traded volume to count one side of the transaction. The company previously counted total client volume to include both sides of the transaction. The company posts Knight Hotspot FX volume statistics each month to its web site, which has been updated to show one-sided volume statistics dating back to the beginning of 2011.

N/M - Not meaningful

Total revenues from the Global Execution Services segment, which primarily comprises Commissions and fees and Net trading revenues from agency execution activity, decreased 12.8% to \$122.4 million for the three months ended March 31, 2013, from \$140.3 million for the comparable period in 2012. Revenues were negatively impacted by a decline in client volumes from our listed derivatives and institutional equities businesses offset, in part, by increased revenues from our reverse mortgage business and the addition of our futures business, which was acquired in June 2012.

Corporate and Other

	For the three months ended			
	March 31,			
	2013	2012	Change	% of Change
Total Revenues from Corporate and Other (thousands)	\$ 12,054	\$ 10,036	\$ 2,018	20.1 %

Total revenues from the Corporate and Other segment, which primarily represent interest income from our stock borrow activity, gains or losses on strategic investments and deferred compensation investments related to certain employees and directors increased to \$12.1 million for the three months ended March 31, 2013, from \$10.0 million for the comparable period in 2012. The primary driver for the increase in revenues was higher gains from our strategic investments.

Expenses

Employee compensation and benefits expense decreased to \$107.8 million for the three months ended March 31, 2013 from \$112.3 million for the comparable period in 2012. As a percentage of total revenues, Employee compensation and benefits increased slightly to 37.8% for the three months ended March 31, 2013, from 37.1% for the comparable period in 2012. As a percentage of revenues, excluding compensation expenses related to reductions in our workforce of \$8.9 million, Employee compensation and benefits decreased to 34.7% for the three months ended March 31, 2013, from 37.1% for the comparable period in 2012. The decrease on a dollar basis was primarily due to an overall decrease in revenues and profitability and change in the mix of our revenues across businesses in addition to a reduction in the number of employees offset, in part, by higher costs associated with a reduction in our workforce.

The number of full time employees decreased to 1,269 at March 31, 2013 as compared to 1,299 at March 31, 2012. Both periods exclude employees affected by the announced sale of our institutional fixed income sales and trading business. The decrease is due to the first quarter 2013 reduction in workforce offset, in part, by the acquisition of our futures business. 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 decreased 3.6% to \$50.5 million for the three months ended March 31, 2013, from \$52.3 million for the comparable period in 2012. Execution and clearance fees decreased on a dollar basis due to decrease in equity volumes. Execution and clearance fees fluctuate based on changes in transaction volumes, shift in business mix, regulatory fees and operational efficiencies and scale.

Payments for order flow increased 61.8% to \$35.1 million for the three months ended March 31, 2013, from \$21.7 million for the comparable period in 2012. The increase is primarily due to a lower revenue base, additional costs as we regain market share, and adjustments to payment rates as well as an increase in fees paid to third party brokers on increased wholesale reverse mortgage loan production. As a percentage of total revenue, Payments for order flow increased to 12.3% for the three months ended March 31, 2013, from 7.2% for the comparable period in 2012.

Payments for order flow fluctuate as a percentage of revenue due to changes in volume, reverse mortgage loan production, client and product mix, profitability, and competition.

Professional fees increased to \$13.0 million for the three months ended March 31, 2013, from \$4.9 million for the comparable period in 2012 due to higher consulting expenses and legal costs related to our August 1, 2012 trading loss and the announced GETCO Merger. Excluding the \$9.3 million fees related to the Merger and August 1, 2012 trading loss, Professional fees decreased to \$3.8 million for the three months ended March 31, 2013.

All other expenses increased by 13.5%, or \$8.8 million, to \$73.9 million for the three months ended March 31, 2013 from \$65.1 million for the comparable period in 2012. Communications and data processing expense increased primarily due to higher market data and connectivity expenses as a result of the addition of our futures business. Interest expense decreased slightly primarily due to decrease in our securities lending activity. Occupancy and equipment rentals expense remained relatively flat. Business development expense decreased due to fewer client-related events and lower advertising costs. Other expenses increased due to higher reserves associated with the increase in our GNMA issuances.

Our effective tax rate for the three months ended March 31, 2013 from continuing operations of 38.5% differed from the federal statutory rate of 35% primarily due to state and local income taxes and non-deductible charges. Our effective tax rate for the three months ended March 31, 2012 from continuing operations of 38.9% differed from the federal statutory rate of 35% primarily due to state and local income taxes and non-deductible charges.

Reconciliation of GAAP Pre-Tax to Non-GAAP Pre-Tax Earnings

We believe that certain non-GAAP financial presentations, when taken into consideration with the corresponding GAAP financial presentations, are important in understanding our operating results. The adjustments incorporate the effects of professional fees related to the announced merger with GETCO and August 1, 2012 technology issue, and compensation expenses related to a reduction in workforce. We believe this presentation provides meaningful information to shareholders and investors as they provide comparability for our results of operations for the quarter ended March 31, 2013 with the results for the quarter ended March 31, 2012. The following table provides a full reconciliation of GAAP to non-GAAP pre-tax results for the three months ended March 31, 2013 (in thousands):

Three months ended March 31, 2013	Market Making	Global Execution Services	Corporate and Other	Consolidated
Reconciliation of GAAP Pre-Tax to Non-GAAP Pre-Tax:				
GAAP Income (loss) from continuing operations before income taxes	\$36,550	\$10,717	\$(29,363)	\$17,904
Professional fees related to merger and August 1st Loss	—	—	9,252	9,252
Compensation expenses related to reduction in workforce	230	4,410	4,277	8,917
Non-GAAP Income (loss) from continuing operations before income taxes	\$36,780	\$15,127	\$(15,834)	\$36,073
Totals may not add due to rounding				

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 March 31, 2013 and December 31, 2012, we had total assets of \$10.91 billion and \$9.78 billion, respectively, a portion of which consisted of cash or assets readily convertible into cash as follows (in thousands):

	March 31, 2013	December 31, 2012
Cash and cash equivalents	\$439,182	\$413,926
Financial instruments owned, at fair value:		
Equities	1,538,856	1,463,916
U.S. government and Non-U.S. government obligations	21,220	34,339
Corporate debt	125,298	76,818
Listed equity options	231,044	202,091
Collateralized agreements:		
Securities borrowed	1,414,794	1,008,720
Receivables from brokers, dealers and clearing organizations	1,107,202	868,805
Assets of business held for sale	109,138	310,868
Total cash and assets readily convertible to cash	\$4,986,734	\$4,379,483

Totals may not add due to rounding.

Substantially all of the amounts disclosed in the table above can be liquidated into cash within five business days under normal market conditions, however, the liquidated values may be subjected to haircuts during distressed market conditions as we saw following our August 1, 2012 trading loss. In April 2013, we received a tax refund of \$107.8 million from the Internal Revenue Service as a result of the carryback of 2012 tax losses which were primarily as a result of our August 1, 2012 trading loss. The receivable was included within Income taxes receivable on our Consolidated Statements of Financial Condition.

Financial instruments owned principally consist of equities and listed equity options that trade on the NYSE, NYSE Amex and NYSE Arca markets, Nasdaq and on the OTC Bulletin Board as well as securitized HECM loan inventories.

Securities borrowed represent the value of cash or other collateral deposited with securities lenders to facilitate our trade settlement process.

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.

As of March 31, 2013 and December 31, 2012, \$1.05 billion and \$1.08 billion, respectively, of equities have been pledged as collateral to third-parties under financing arrangements.

Other assets primarily represent deposits, net deferred tax assets and other miscellaneous receivables.

Total assets increased 1.13 billion, or 11.6%, from \$9.78 billion at December 31, 2012 to \$10.91 billion at March 31, 2013. The majority of the increase in assets relates to the growth of our financial instruments owned. Financial instruments owned increased by \$840.9 million, or 14.0%, from \$6.02 billion at December 31, 2012, to \$6.86 billion at March 31, 2013, primarily due to the \$737.4 million increase in securitized HECM loan inventory, which represents HECM loans that have been securitized into GNMA securities which have been sold to third parties but where the securitization is not accounted for as a sale under current accounting standards while the remaining increase relates to increases in our inventory related to our market making business. Our securities inventory fluctuates based on trading volumes, market conditions, trading strategies utilized and our pre-determined risk limits. Securities borrowed increased by \$406.1 million, from \$1.01 billion at December 31, 2012 to \$1.41 billion at March 31, 2013. This increase is related to the increases in our short trading inventory in addition to the increase in our balance at clearing brokers included within Receivable from brokers, dealers and clearing organizations that also assist in funding our inventory.

Receivable from brokers, dealers and clearing organizations increased by \$238.4 million, from \$868.8 million at December 31, 2012 to \$1.11 billion at March 31, 2013, due to increased deposits at third party clearing organizations including customer balances related to our futures business as well as timing relating to trade date versus settlement date differences. The increase was offset, in part, by a decrease in Assets of business held for sale which decreased \$303.8 million from \$449.5 million at December 31, 2012 to \$145.7 million at March 31, 2013, primarily due to a decrease in fixed income securities positions as we near the agreed upon sale of our fixed income business. Total liabilities increased \$1.13 billion, or 13.6%, from \$8.3 billion at December 31, 2012 to \$9.43 billion at March 31, 2013. The majority of the increase in liabilities relates to increases in Collateralized financings and Payable to customers. Collateralized financings increased by \$1.08 billion, or 21.6%, from \$5.01 billion at December 31, 2012, to \$6.09 billion at March 31, 2013 primarily due to the increased Liability to GNMA trusts, at fair value associated with the securitization of HECM loans into GNMA securities, where such securitization is not accounted for as a sale. Financial instruments sold, not yet purchased increased by \$281.4 million, or 19.5%, from \$1.45 billion at December 31, 2012, to \$1.73 billion at March 31, 2013, primarily due to a increase in the size of the securities inventory utilized in our equity and option market making activities. Our securities inventory fluctuates based on trading volumes, market conditions, trading strategies utilized and our pre-determined risk limits. The increase in Financial instruments sold, not yet purchased is consistent with the increase in our long securities position within our market making business. Payable to customers increased by \$73.4 million, from \$388.7 million at December 31, 2012 to \$462.0 million at March 31, 2013, primarily due to the expansion of our futures business. Liabilities of business held for sale decreased by \$272.0 million, from \$357.7 million at December 31, 2012 to \$85.6 million at March 31, 2013, primarily due to the agreed upon sale of our institutional fixed income sales and trading business. Stockholders' equity, increased by \$233.3 million, from \$1.25 billion at December 31, 2012 to \$1.49 billion at March 31, 2013. The increase in stockholders' equity from December 31, 2012 was primarily a result of the conversion of our remaining convertible preferred stock into Class A common stock during the first quarter of 2013.

Liquidity and Capital Resources

Historically we have financed our business primarily through cash generated by operations, our long-term debt and other borrowings. On August 6, 2012 we raised \$400.0 million in equity financing through the issuance of Series A convertible preferred stock to certain investors (the "August 2012 Recapitalization"). We incurred approximately \$40.5 million of fees and costs related to the offering, resulting in net proceeds of \$359.5 million.

Effective February 28, 2013, all shares of our Series A convertible preferred stock ("Series A Preferred Stock") were mandatorily converted into shares of Class A common stock as a result of the Company's Class A common stock having traded above 200% of the \$1.50 per share conversion price for 60 consecutive trading days.

At March 31, 2013, we had net current assets, which consist of net assets readily convertible into cash less current liabilities, of approximately \$1.23 billion.

We have acquired several businesses over the last few years. In July 2010, we acquired Urban Financial Group, Inc. ("Urban") for \$28.4 million, comprising \$19.4 million in cash, approximately 350,000 shares of unregistered Knight Class A common stock valued at \$5.0 million and a potential earn-out based on future performance valued at \$4.7 million. Urban achieved its first and second year performance targets as of July 31, 2011 and 2012, respectively.

Therefore, the seller received \$1.3 million split evenly between cash and unregistered shares of Knight common stock in each of those years. In June 2012, we acquired certain assets and assumed certain liabilities of Penson Futures, the futures division of Penson Financial Services, Inc. for \$5.0 million in cash and a potential earn-out based on future performance with an estimated fair value of \$3.5 million. We expect to fund the purchase price of any future acquisitions with our current cash position or, in some cases, through the issuance of our stock or debt.

Net income from continuing operations was \$11.0 million for the three months ended March 31, 2013 and \$31.2 million for the three months ended March 31, 2012. 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 \$12.0 million and \$11.0 million for the three months ended March 31, 2013 and 2012, respectively. Depreciation and amortization expense was \$9.7 million and \$11.6 million for the three months ended March 31, 2013 and 2012, respectively. There were no non-cash writedowns for the three months ended March 31, 2013 or 2012.

Capital expenditures related to our continuing operations were \$5.3 million and \$7.6 million during the three months ended March 31, 2013 and 2012, respectively. Purchases of investments were \$1.1 million and \$9.5 million during the

three months ended March 31, 2013 and 2012, respectively. Dividends and distributions received from

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investments were \$4.6 million and \$1.4 million for the three months ended March 31, 2013 and 2012, respectively. There were no payments relating to acquisitions of businesses, trading rights and other items, net of cash received during the three months ended March 31, 2013 and 2012, respectively.

In March 2010, we issued Cash Convertible Senior Subordinated Notes (“Notes”) with a face amount of \$375.0 million 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 termination and required repayment of the borrowings under our previous \$140.0 million credit agreement including 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 3.50% 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. For the three months ended March 31, 2013 and 2012, we recognized interest expense related to the Notes of \$7.0 million and \$6.7 million, respectively.

In June 2011, we entered into a \$100.0 million three-year Term Loan Credit Agreement (the “Term Credit Agreement”) with a consortium of banks. As of December 31, 2012, the Company has borrowed all the funds under the Term Credit Agreement and the interest rate was 2.72% per annum, which is based on the one month LIBOR rate plus 2.50%. Interest is paid monthly. The Term Credit Agreement is repayable in three installments as follows: \$25.0 million on June 28, 2013, \$25.0 million on December 27, 2013 and \$50.0 million on June 27, 2014. For each of the three months ended March 31, 2013 and 2012, we recognized interest expense related to the Term Credit Agreement of \$0.7 million.

On May 7, 2013, we repaid all amounts outstanding under, and terminated, the Term Credit Agreement. We used a portion of the proceeds received from a federal tax refund to repay the Term Credit Agreement. The borrowings under the Term Credit Agreement were payable in full by June 27, 2014. There were no penalties for early termination.

In June 2011, we also entered into a \$200.0 million one-year Revolving Credit Agreement (the “Revolving Credit Agreement”) with Knight Execution & Clearing Services LLC (“KECS”) and Knight Capital Americas, L.P., as borrowers, with a consortium of banks. Borrowings under the Revolving Credit Agreement bear interest at a rate equal to the greater of the federal funds rate or the one month LIBOR rate plus a margin ranging from 1.50% – 2.00% per annum. Interest is payable quarterly. In June 2012, we renewed our Revolving Credit Agreement with substantially the same consortium of banks on substantially the same terms and conditions as the Revolving Credit Agreement. As a result of the consolidation of Knight Capital Americas, L.P. into KECS as of June 30, 2012, and the subsequent renaming of KECS to Knight Capital Americas LLC (“KCA”), KCA is now the sole borrower under the Revolving Credit Agreement. In August 2012, we drew down the full \$200.0 million available under our Revolving Credit Agreement and repaid in full by the next business day. As of March 31, 2013, and December 31, 2012 there were no outstanding borrowings under the Revolving Credit Agreement. We are charged an annual commitment fee of 0.25% on the average daily amount of the unused portion of the Revolving Credit Agreement. For each of the three months ended March 31, 2013 and 2012, we recorded \$0.1 million in commitment fees. The Revolving Credit Agreement was renewed with substantially the same consortium of banks on substantially the same terms and conditions as the Term Credit Agreement on June 27, 2012 and will expire on June 26, 2013.

In December 2012, Knight entered into amendments to the Term Credit Agreement and Revolving Credit Agreement. These amendments were made to clarify treatment of losses related to securities transactions and amend certain other provisions described therein.

In August 2012, we raised \$400.0 million in equity financing through the August 2012 Recapitalization. Under the terms of the August 2012 Recapitalization, we sold 400,000 shares of Series A Preferred Stock. We incurred approximately \$40.5 million of fees and costs related to the issuance resulting in net proceeds of \$359.5 million.

Dividends on the Series A Preferred Stock accrued daily and were payable quarterly, in arrears, on each January 15, April 15, July 15 and October 15, commencing on October 15, 2012, in cash at a rate per annum equal to 2% of the liquidation preference of \$1,000 per share. During 2012, we declared two quarterly dividends with respect to the Series A Preferred Stock. The first dividend which was paid on October 15, 2012 totaled \$1.1 million based upon 274,215 Series A Preferred Stock outstanding as of the record date covering the period from August 6, 2012 through October 14, 2012. The second dividend which was paid on January 15, 2013 totaled \$1.2 million based upon 243,463 Series A Preferred Stock outstanding as of the record date covering the period from October 15, 2012 through January 15, 2013. As the second dividend was declared prior to December 31, 2012, it was reflected in the

Consolidated Financial Statements for the year ended December 31, 2012 as a reduction in Retained earnings and in the earnings per share calculation as an increase in the loss attributable to the common stockholders. There were no dividends declared in 2013 as all of the Series A Preferred Stock had been converted into Class A common stock.

See Footnote 12 “Long-Term Debt,” and Footnote 3 “Series A Convertible Preferred Stock” included in Part I, Item 1 “Financial Statements” of our Form 10-Q filed on May 9, 2013 for further information regarding the Notes, Term Credit Agreement and Revolving Credit Agreement; and Series A Convertible Preferred Stock, respectively.

We have an authorized stock repurchase program of \$1.00 billion. We did not repurchase any shares under the stock repurchase program during the first quarter of 2013. Through March 31, 2013, we had repurchased 76.7 million shares for \$879.1 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. 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 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. The terms of our Series A Preferred Stock prohibit us from repurchasing any shares if dividends on such shares are in arrears. We had 375.1 million shares of Class A common stock outstanding as of March 31, 2013.

Our U.S. registered broker-dealer is subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers and FCMs and require the maintenance of minimum levels of net capital, as defined in SEC Rule 15c3-1 as well as other capital requirements from several commodity organizations including the Commodities Futures Trading Commission (“CFTC”) and the National Futures Association (“NFA”). 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, CFTC and other regulators 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 and the CFTC have the ability to prohibit or restrict such transactions if the result is detrimental to the financial integrity of the broker-dealer. As of March 31, 2013, our broker-dealers were in compliance with the applicable regulatory net capital rules. The following table sets forth the net capital level and requirements for our regulated U.S. broker-dealer subsidiary at March 31, 2013, as reported in its respective regulatory filing (in thousands):

Entity	Net Capital	Net Capital Requirement	Excess Net Capital
Knight Capital Americas LLC	\$293,577	\$23,963	\$269,614

Our foreign registered broker-dealers are subject to certain financial resource requirements of either Financial Services Authority (“FSA”) or the Securities and Futures Commission (“SFC”). The following table sets forth the financial resource requirement for the following significant foreign regulated broker-dealer at March 31, 2013 (in thousands)

Entity	Financial Resources	Resource Requirement	Excess Financial Resources
Knight Capital Europe Limited	\$116,307	\$43,651	\$72,656

On December 19, 2012, Knight, GETCO Holding Company, LLC (“GETCO”) and an affiliate of GETCO entered into an agreement and plan of merger, which was subsequently amended and restated on April 15, 2013 to adjust the exchange ratios but not the aggregate consideration (the “Merger Agreement”) for a strategic business combination. As a result of the proposed strategic business combination (the “Merger”), Knight and GETCO will each become a wholly owned subsidiary of KCG Holdings, Inc., a newly-formed Delaware corporation (“KCG”). The business of KCG will be the combined business of Knight and GETCO.

Under the Merger Agreement, existing Company common stockholders (other than GETCO and holders of Company restricted stock or other equity awards granted after December 19, 2012) will have the right to elect to receive \$3.75 per share in cash or one third of a share of common stock of KCG for each share of Company Class A common stock they own immediately prior to the completion of the transaction. The cash consideration will be subject to pro-ration if the holders of more than 66.7% of the Company’s Class A common stock eligible for election in the transaction properly elect to receive the cash consideration for their Company shares. Jefferies & Company, Inc. and its affiliates (“Jefferies”), the largest stockholders of the Company, have agreed to limit their cash election to 50.0% of their

Company shares to the extent the total cash consideration would otherwise exceed \$720.0 million. This is intended to enable

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other Company stockholders (excluding GETCO and holders of Company restricted stock or other equity awards granted after December 19, 2012) to receive up to 66.7% of their total consideration in cash, while limiting the total cash consideration to be paid by KCG to not more than \$720.0 million in the aggregate.

If the transaction is completed, GETCO unitholders are expected to receive, in aggregate, approximately 76 million shares of common stock of KCG and up to 25 million warrants to acquire shares of common stock of KCG. The warrants will be comprised of 8.33 million Class A warrants, having a \$12.00 exercise price and exercisable for a four-year term; 8.33 million Class B warrants, having a \$13.50 exercise price and exercisable for a five-year term; and 8.33 million Class C warrants, having a \$15.00 exercise price and exercisable for a six-year term. The number of shares of common stock may increase or decrease based on the number of GETCO units outstanding as of the closing date.

GETCO entered into a commitment letter, with affiliates of Jefferies for the financing necessary to complete the business combination, including refinancing all existing Knight and GETCO debt. Pursuant to the commitment letter, Jefferies committed to provide a first lien term loan facility in an aggregate principal amount of up to \$450.0 million, a first lien revolving facility in an aggregate principal amount of \$20.0 million and a second lien bridge loan facility in an aggregate principal amount of up to \$550.0 million. On February 5, 2013, GETCO and Jefferies entered into a joinder agreement with Goldman Sachs Bank USA (“Goldman Sachs”). Pursuant to the joinder agreement, Goldman Sachs agreed to provide a portion of the financing agreed to in the commitment letter for the first lien term loan facility, the first lien revolving facility and the second lien bridge loan facility. In addition, Jefferies and Goldman are expected to arrange an offering of senior secured second lien notes by the new holding company yielding aggregate gross proceeds of up to \$550.0 million. The proceeds of the senior secured second lien notes, if any, would reduce the funded amount of the second lien bridge loan facility or, if the second lien bridge loan facility were previously funded, be used to repay the bridge loans made thereunder. These financings will be subject to customary affirmative and negative covenants.

The Merger is expected to be completed in mid-2013, subject to the approval by Knight’s stockholders and GETCO’s voting unitholders, customary regulatory approvals and satisfaction of customary closing conditions.

Off-Balance Sheet Arrangements

As of March 31, 2013, 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

The majority of our assets are liquid in nature and therefore are not significantly affected by inflation. However, the rate of inflation may affect our 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 us. To the extent inflation results in rising interest rates and has other adverse effects on the securities markets, it may adversely affect our financial position and results of operations.

Discontinued Operations and Assets Held for Sale

During the first quarter of 2013, we announced that we were discontinuing our correspondent clearing business. As a result, this business has been classified as a discontinued operation and the results of its operations have been included in discontinued operations on the Consolidated Statements of Operations for all periods presented.

During the first quarter of 2013, we agreed to sell our institutional fixed income sales and trading business which operates in the U.S. and in the U.K., to Stifel, Nicolaus & Company, Inc. We expect to complete the transaction during the second quarter of 2013. As a result of our decision to sell this business, this business has been classified as held for sale and the results of its operations have been included in discontinued operations within the Consolidated Statements of Operations for all periods presented. The assets and liabilities associated with this business are recorded as Assets of business held for sale and Liabilities of business held for sale, respectively on the Consolidated Statements of Financial Condition.

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

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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 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 12 “Long-Term Debt,” included in Part I, Item 1 “Financial Statements” of our Form 10-Q filed on May 9, 2013, we entered into purchased call options and recorded an embedded conversion derivative concurrent with our issuance of the Notes. The fair value of these options and derivative 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.

Our loan inventory, foreign currency forward contracts, investment in the Deephaven Funds, deferred compensation investments and certain mortgage-backed securities 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 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 March 31, 2013 and December 31, 2012, 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.

Securitization activities—We securitize HECMs under our GNMA issuance authority. Securitization and transfer of financial assets are generally accounted for as sales when an issuer has relinquished control over the transferred assets. Based upon the current structure of the GNMA securitization program, we believe that we have not met the GAAP criteria for relinquishing control over the transferred assets and therefore our securitizations fail to meet the GAAP criteria for sale accounting. As such, we continue to recognize the HECMs in Financial instruments owned, at fair value, and we recognize a corresponding liability in Liability to GNMA trusts, at fair value on the Consolidated Statements of Financial Condition.

Goodwill and Intangible Assets—As a result of our various acquisitions, 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 intangible assets with an indefinite useful life for impairment at least annually or when an event occurs or circumstances change that signifies the existence of impairment.

Goodwill

Goodwill of \$213.9 million at March 31, 2013 primarily relates to our Global Execution Services segment. We test the goodwill in each of our reporting units for impairment at least annually by comparing the estimated fair value of each reporting unit with its estimated net book value. We derive the fair value of each of our reporting units based on valuation techniques we believe market participants would use for each segment (observable market multiples and discounted cash flow analyses) and we derive the net book value of our reporting units by estimating the amount of shareholders' equity required to support the activities of each reporting unit. As part of our test for impairment, we also consider the profitability of the applicable reporting unit as well as our overall market value, compared to our book value. We performed our annual test for impairment of goodwill in the second quarter of 2012 and determined that goodwill was not impaired at that time. No events occurred during the three months ended March 31, 2013 that would indicate that our goodwill may not be recoverable.

Intangible Assets

Intangible assets, less accumulated amortization, of \$53.2 million at March 31, 2013 are primarily attributable to our Global Execution Services segment. We amortize these assets, which primarily consist of customer relationships on a straight-line basis over their useful lives, the majority of which have been determined to range from two to 17 years. We test amortizable intangibles for recoverability whenever events indicate that the carrying amounts may not be recoverable. No other events occurred during the three months ended March 31, 2013 that would indicate that the carrying amounts of our intangible assets may not be recoverable. During the first quarter of 2013, we wrote off intangible assets relating to customer relationships within our fixed income business of \$8.3 million which was included within (Loss) income from Discontinued operations, net of tax on the Consolidated Statements of Operations.

Investments—Investments primarily comprise strategic investments and deferred compensation investments. 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. We use the equity method of accounting when we have significant influence, generally considered to be between 20% and 50% equity ownership or greater than 3% to 5% of a partnership interest. We hold strategic investments at cost, less impairment if any, when we are not considered to exert significant influence on operating and financial policies of the investee. We account for our deferred compensation investments, which primarily consist of mutual funds, at fair value.

We review investments on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If we assess that an impairment loss on a strategic investment has occurred due to a decline in fair value or other market conditions, we write the investment down to its estimated impaired value.

We maintain a deferred compensation plan related to certain employees and directors. This plan provides a return to the participants based upon the performance of various investments. In order to hedge our liability under this plan, we generally acquire the underlying investments and hold such investments until the deferred compensation liabilities are satisfied. We record changes in value of such investments in Investment income and other, net, with a corresponding charge or credit to Employee compensation and benefits on the Consolidated Statements of Operations.

Market Making, Sales, Trading and Execution Activities—Financial instruments owned and Financial instruments sold, not yet purchased, which relate to market making and trading activities, include listed and OTC equity securities, listed equity options and fixed income securities which are recorded on a trade date basis and carried at fair value. Net trading revenue (trading gains, net of trading losses) and commissions (which includes commission equivalents earned on institutional client orders, futures transactions, and HECM loan originations and securitization activities) 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. The Company also nets interest income on its securitized HECM loan inventory against interest expense on its liability to GNMA trusts.

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.

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 the event we are able to sublease the excess real estate after recording a lease loss, such accrual is adjusted to the extent the actual terms of sub-leased property differ from

the assumptions used in the calculation of the accrual. In the event that we conclude that previously determined excess real estate is needed for our use, such lease loss accrual is adjusted accordingly. Any such adjustments to previous lease loss accruals are recorded in Writedown of assets and lease loss accrual on the Consolidated Statements of Operations

Income taxes—We record 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 measure them using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. We evaluate 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.

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 discontinued operations, 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.

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 our Annual Report on Form 10-K/A for the year ended December 31, 2012 and other reports or documents the Company files with, or furnishes, to the SEC from time to time.

Revenues and expenses associated with a business line that has been disposed of through closure or held sale are included in (Loss) income from discontinued operations, net of tax on the Consolidated Statements of Operations. Assets and liabilities of business held for sale or discontinued operations are included in Assets of business held for sale and discontinued operations and Liabilities of business held for sale and discontinued operations, 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

Accounting Standards Updates

Recently adopted accounting guidance

In December 2011, the Financial Accounting Standards Board (“FASB”) issued an Accounting Standard Update (“ASU”) that requires additional disclosures about financial assets and liabilities that are subject to netting arrangements. Under the ASU, financial assets and liabilities must be disclosed at their respective gross asset and liability amounts, the amounts offset on the balance sheet and a description of the respective netting agreements. The new disclosures are required for reporting periods beginning on or after January 1, 2013, and are to be applied retrospectively. Other than requiring additional disclosures, the adoption of this ASU did not have an impact on our Consolidated Financial Statements.

In February 2013, the FASB issued an ASU that requires additional disclosure requirements for items reclassified out of accumulated other comprehensive income. This new guidance requires entities to present either on the face of the

income statement or in the notes to the financial statements; the effects on the specific line items of the income

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statement for amounts reclassified out of accumulated other comprehensive income. This ASU is effective for reporting periods beginning after December 15, 2012. Other than requiring additional disclosures, the adoption of this ASU did not have an impact on our Consolidated Financial Statements.

Recent accounting guidance to be adopted in future periods

In March 2013, the FASB issued an ASU concerning parent's accounting for the cumulative translation adjustment upon derecognition of certain subsidiaries of groups of assets within a foreign entity or of an investment in a foreign entity. This ASU provides for the release of the cumulative translation adjustment into net income when a parent sells a part or all of its investment within a foreign entity, no longer holds a controlling interest in an investment in a foreign entity or obtains control of an investment in a foreign entity that was previously recognized as an equity method investment. This ASU is effective for reporting periods beginning after December 15, 2013, however early adoption is permitted. We are evaluating the impact of this ASU on our Consolidated Financial Statements.

PART II OTHER INFORMATION

Item 6. Exhibits
NUMBER ASSIGNED
TO EXHIBIT (I.E. 601
OF REGULATION S-K)

DESCRIPTION OF EXHIBITS

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.

* Filed herewith.

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 10th day of May 2013.

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)