LABRANCHE & CO INC
Form 10-Q
November 09, 2004
Table of Contents

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, 2004

OR

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from __________ to __________

Commission File Number 001-15251

LABRANCHE & CO INC.

(Exact name of registrant as specified in its charter)

Delaware	**13-4064735**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

One Exchange Plaza, New York, New York 10006

(Address of principal executive offices)

(212) 425-1144

(Registrant s telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year,

if changed since last report)

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

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

The number of shares of the registrant s common stock outstanding as of November 9, 2004 was 60,038,190.

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

LaBRANCHE & CO INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

(000 s omitted except per share data)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2004	2003	2004	2003
	(unaudited)	(unaudited)	(unaudited)	(unaudited)
REVENUES:				
Net gain on principal transactions	$ 38,997	$ 45,019	$ 131,740	$ 157,013
Commissions	22,064	23,371	71,311	70,746
Net realized and unrealized gain on non-marketable investments	178	472	24,527	765
Other	3,421	2,042	7,697	6,518
Total revenues	64,660	70,904	235,275	235,042
EXPENSES:				
Employee compensation and related benefits	21,985	25,324	72,421	76,239
Interest	16,006	12,113	47,700	36,041
Exchange, clearing and brokerage fees	10,101	9,260	28,684	30,858
Lease of exchange memberships	3,804	6,118	11,902	18,773
Depreciation and amortization of intangibles	3,057	3,128	9,162	9,717
Goodwill impairment	37,600		37,600	
Exchange memberships impairment			18,327	
Debt repurchase premium			49,028	
Other	9,941	8,665	29,927	23,812
Total expenses	102,494	64,608	304,751	195,440
Income (loss) before minority interest and provision (benefit) for income taxes	(37,834)	6,296	(69,476)	39,602
MINORITY INTEREST	161	167	530	294
Income (loss) before provision (benefit) for income taxes	(37,995)	6,129	(70,006)	39,308
PROVISION (BENEFIT) FOR INCOME TAXES	(1,533)	2,917	(16,958)	18,979
Net income (loss)	(36,462)	3,212	(53,048)	20,329
Preferred dividends and discount accretion	142	950	2,254	3,059

Net income (loss) applicable to common stockholders	$ (36,604)	$ 2,262	$ (55,302)	$ 17,270
Weighted-average common shares outstanding:				
Basic	59,926	59,649	59,852	59,557
Diluted	59,926	60,171	59,852	60,134
Earnings (loss) per share:				
Basic	$ (0.61)	$ 0.04	$ (0.92)	$ 0.29
Diluted	$ (0.61)	$ 0.04	$ (0.92)	$ 0.29

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

LaBRANCHE & CO INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

(UNAUDITED)

(000 s omitted except per share data)

	As of	
	September 30, 2004	**December 31, 2003**
	(unaudited)	**(audited)**
ASSETS		
Cash and cash equivalents	$ 437,650	$ 491,885
Cash and securities segregated under federal regulations	4,605	3,959
Securities purchased under agreements to resell	72,000	13,000
Receivable from brokers, dealers and clearing organizations	147,811	142,639
Receivable from customers	6,568	3,434
Securities owned, at market value:		
Corporate equities	491,660	265,568
Options	109,141	73,694
Exchange-traded funds	172,989	102,626
U.S. Government obligations	250	
Commissions receivable	4,903	4,613
Exchange memberships contributed for use, at market value	10,845	15,000
Exchange memberships owned, at adjusted cost (market value of $47,910 and $58,870, respectively)	59,332	77,319
Office equipment and leasehold improvements, at cost, less accumulated depreciation and amortization of $10,188 and $8,931, respectively	3,724	4,659
Intangible assets, net of accumulated amortization:		
Specialist stock lists	363,798	371,580
Trade name	25,011	25,011
Goodwill	251,993	289,593
Income taxes receivable	17,047	
Other assets	43,149	75,022
Total assets	$ 2,222,476	$ 1,959,602
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Payable to brokers and dealers	$ 77,762	$ 45,172
Payable to customers	4,627	9,010
Securities sold, but not yet purchased, at market value:		
Corporate equities	360,033	232,942
Options	84,578	67,079
Exchange-traded funds	261,842	115,140
U.S. Government obligations	22,450	
Accrued compensation	27,121	42,833
Accounts payable and other accrued expenses	31,232	99,844
Income taxes payable		8,588

Deferred tax liabilities	158,152	172,846
Short term debt	2,000	101,971
Long term debt	481,538	255,606
Subordinated liabilities:		
Exchange memberships contributed for use, at market value	10,845	15,000
Other subordinated indebtedness	17,285	20,285
Total liabilities	1,539,465	1,186,316
Minority interest	530	322
Commitments and contingencies		
Preferred stock, Series A, $.01 par value, liquidation value of $1,000 per share; 10,000,000 shares authorized; -0- and 39,186 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively		38,317
Common stock, $.01 par value, 200,000,000 shares authorized; 60,038,190 and 59,791,036 shares issued and outstanding at September 30, 2004 and December 31, 2003, respectively	600	598
Additional paid-in capital	685,808	682,816
Retained earnings (accumulated deficit)	(3,927)	51,374
Unearned compensation		(141)
Total stockholders equity	682,481	772,964
Total liabilities and stockholders equity	$ 2,222,476	$ 1,959,602

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

-4-

Table of Contents

LaBRANCHE & CO INC. and SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(000 s omitted)

	Nine Months Ended September 30,	
	2004	**2003**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (53,048)	$ 20,329
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization of intangibles	9,162	9,717
Amortization of debt issuance costs and bond discount	6,977	1,596
Minority interest in consolidated subsidiary	530	294
Compensation expense related to stock-based compensation	3,161	2,611
Deferred tax provision	12,840	4,510
Exchange memberships impairment	18,327	
Goodwill impairment	37,600	
Acceleration of preferred stock discount accretion	496	918
Tax benefit related to employee stock transactions		433
Changes in operating assets and liabilities:		
Cash and securities segregated under federal regulations	(646)	8,950
Securities purchased under agreements to resell	(59,000)	15,300
Receivable from brokers, dealers and clearing organizations	(5,172)	(75,676)
Receivable from customers	(3,134)	8,068
U.S. Government obligations		395,840
Securities owned, at market value:		
Corporate equities	(226,092)	(146,742)
Options	(35,447)	(3,321)
Exchange-traded funds	(70,363)	(128,069)
U.S. Government obligations	(250)	
Commissions receivable	(290)	(84)
Income taxes receivable	(17,047)	
Other assets	(320)	2,318
Payable to brokers and dealers	32,590	16,993
Payable to customers	(4,383)	2,972
Securities sold, but not yet purchased, at market value:		
Corporate equities	127,091	122,695
Options	17,499	(895)
Exchange-traded funds	146,702	81,899
U.S. Government obligations	22,450	
Accrued compensation	(15,712)	(14,881)
Accounts payable and other accrued expenses	(67,044)	(19,585)
Income taxes payable	(8,588)	(4,471)
Net cash (used in) provided by operating activities	(131,111)	301,719

CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments for purchases of office equipment and leasehold improvements	(470)	(721)
Payments for exchange memberships	(340)	(19)
Net cash (used in) investing activities	(810)	(740)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payment to minority interest holder	(322)	
Proceeds from exercise of stock options		216
Payment of common stock dividends		(14,288)
Payment of preferred stock dividends	(3,448)	(4,313)
Payment for preferred stock buyback	(39,186)	(24,650)
Principal payments of subordinated debt	(3,000)	
Proceeds from issuance of long term debt	460,000	
Repayment of short term and long term debt	(336,358)	
Net cash provided by (used in) financing activities	77,686	(43,035)
(Decrease) increase in cash and cash equivalents	(54,235)	257,944
CASH AND CASH EQUIVALENTS, beginning of period	491,885	77,033
CASH AND CASH EQUIVALENTS, end of period	$ 437,650	$ 334,977
SUPPLEMENTAL DISCLOSURE OF CASH PAID FOR:		
Interest	$ 31,306	$ 42,203
Income taxes	393	16,193
SUPPLEMENTAL NON-CASH FINANCING AND INVESTING ACTIVITIES:		
Net increase in additional paid-in capital related to stock-based awards	3,134	3,198
Satisfaction of secured demand notes through release of collateral	$	$ 8,000

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

LaBRANCHE & CO INC. and SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

1. ORGANIZATION AND DESCRIPTION OF BUSINESS

The condensed consolidated financial statements include the accounts of LaBranche & Co Inc., a Delaware corporation (the Holding Company), and its subsidiaries, LaBranche & Co. LLC, a New York limited liability company (LaBranche & Co. LLC), LaBranche Financial Services, Inc., a New York corporation (LFSI), LaBranche Structured Products, LLC, a New York limited liability company (LSP), LaBranche Structured Products Specialists, LLC, a New York limited liability company (LSPS), LABDR Services, Inc., a Delaware corporation (LABDR), and LaBranche & Co. B.V., a Netherlands private limited liability company (BV and collectively with the Holding Company, LaBranche & Co. LLC, LFSI, LSP, LSPS and LABDR, the Company). The Holding Company is the sole member of LaBranche & Co. LLC, LSP and LSPS, the 100% stockholder of LFSI and LABDR, and the sole owner of BV. LaBranche & Co. LLC is a registered broker-dealer and operates primarily as a specialist in equity securities and rights listed on the New York Stock Exchange (the NYSE) and in equity securities on the American Stock Exchange (the AMEX). LFSI is a registered broker-dealer and a member of the NYSE and other exchanges, and provides securities clearing, securities execution and other related services to its own retail customers, customers of introducing brokers and institutional customers, including traders, professional investors and broker-dealers. LFSI also provides direct-access floor brokerage services to institutional customers. LSP is a registered broker-dealer and operates as a specialist in options, Exchange-Traded Funds (ETFs) and futures on the AMEX, the New York Board of Trade (NYBOT) and the Philadelphia Stock Exchange (PHLX) and as a market-marker in options, ETFs and futures on several exchanges. LSPS is a registered broker-dealer and operates as a specialist in ETFs traded on the NYSE. LABDR provides disaster recovery services and back-up facilities to other Holding Company subsidiaries. BV represents LaBranche & Co. LLC in European markets and provides client services to LaBranche & Co. LLC s European listed companies.

2. INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS AND FINANCIAL INFORMATION

The unaudited interim condensed consolidated financial information as of September 30, 2004 and for the nine months ended September 30, 2004 and 2003 is presented in the accompanying condensed consolidated financial statements. The unaudited interim condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial information. The unaudited interim condensed consolidated financial information reflects all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for such periods. The preparation of condensed consolidated financial statements in conformity with accounting

Table of Contents

principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates and assumptions. Certain prior period amounts have been reclassified to conform to the current period presentation. The unaudited interim condensed consolidated financial information as of September 30, 2004 should be read in conjunction with the audited consolidated financial statements and notes thereto as of December 31, 2003 included in the Company s Annual Report on Form 10-K for the year ended December 31, 2003 (the 2003 10-K) filed with the Securities and Exchange Commission (SEC) on March 15, 2004. Results of the interim periods are not necessarily indicative of results to be obtained for a full fiscal year.

3. DEBT EXTINGUISHMENT AND REFINANCING

On May 18, 2004, in connection with the refinancing of certain of the Company s indebtedness, the Company repurchased approximately $93.1 million of its then-outstanding $100.0 million aggregate principal amount 9.5% senior notes due 2004 (the 2004 Notes) and approximately $236.4 million of its then-outstanding $250.0 million aggregate principal amount 12.0% senior subordinated notes due 2007 (the 2007 Notes and, together with the 2004 Notes, the Old Notes), and paid for related consents delivered by the holders of the Old Notes on or prior to April 19, 2004. The aggregate purchase price paid by the Company for the Old Notes was approximately $386.9 million, which included the purchase price, premium and consent payments of approximately $49.0 million, in the aggregate, and accrued but unpaid interest on the Old Notes up to, but not including, the settlement date. Upon the completion of this debt repurchase and consent solicitation, the indentures governing the remaining outstanding Old Notes were stripped of substantially all restrictive covenants, certain events of default and other related provisions.

In order to fund the repurchase of the Old Notes and related consent solicitation, the Company offered and sold $460.0 million aggregate principal amount of new senior notes (collectively, the Original Senior Notes) to qualified institutional buyers in the United States pursuant to Rule 144A under the Securities Act of 1933, as amended (the Securities Act), and outside the United States pursuant to Regulation S under the Securities Act. The Original Senior Notes consisted of 9.5% Senior Notes due 2009 in the aggregate principal amount of $200.0 million (the Original 2009 Notes) and 11.0% Senior Notes due 2012 in the aggregate principal amount of $260.0 million (the Original 2012 Notes). The indenture governing the Original Senior Notes contains provisions similar to those of the indenture that governed the Old Notes prior to their amendment.

On November 1, 2004, the Company completed an exchange offer in which substantially all the Original 2009 Notes and all the Original 2012 Notes were tendered in exchange for substantially identical Senior Notes registered under the Securities Act (see Note 13).

Table of Contents

4. EXCHANGE MEMBERSHIPS

The Company recognized a charge of approximately $18.3 million to reflect management s determination of an other-than-temporary impairment of the carrying value of the Company s NYSE memberships, based on management s estimate of their fair value, at June 30, 2004. As part of its assessment of the other-than-temporary impairment of these assets, management of the Company considered and evaluated various financial and economic factors directly affecting both the equity securities market as a whole and the specialist industry in particular, including recent sales of NYSE memberships, historical trends of sales and lease prices of NYSE memberships, the current condition of the NYSE market structure and legal and regulatory developments affecting the NYSE market structure.

Of the total $18.3 million impairment charge with respect to exchange memberships, approximately $16.3 million was attributed to the Company s Specialist reporting unit and approximately $2.0 million was attributed to the Company s Execution and Clearing reporting unit.

5. NON-MARKETABLE SECURITIES

In June 2004, the Company recognized a gain of approximately $24.6 million to reflect an increase in the carrying value of its principal non-marketable investment. The adjustment to the fair value of this investment, which reflected a 20% discount relating to escrowed funds, was based on the purchase price agreed to be paid by a major financial institution for all the investee company s outstanding common stock and common stock equivalents. In August 2004, the acquisition was consummated and the Company received cash of approximately $39.0 million, which brought the Company s total gain on this transaction to $24.9 million. Further consideration of approximately $9.5 million (equal to the 20% discount noted above) is being held in escrow to secure indemnification obligations of the former stockholders of the investee company and may be released in whole or in part 15 months after the acquisition was consummated, subject to the final determination of any then-outstanding indemnification claims and any claims regarding taxes. Non-marketable securities are included in Other Assets on the accompanying condensed consolidated statements of financial condition as of September 30, 2004 and December 31, 2003.

6. GOODWILL

In September 2004, the Company recognized a goodwill impairment charge of $37.6 million. Although the Company s annual goodwill impairment testing date is December 31, SFAS No. 142, Goodwill and Other Intangible Assets (SFAS 142), requires that goodwill be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. During the nine months ended September 30, 2004, certain changes in circumstances led management to believe that the fair value of the Company s Specialist reporting unit could be lower than its carrying amount. The factors management considered in deciding to reassess the reasonableness of the carrying value of goodwill primarily related to the continued downward trend in the principal trading revenues at the Company s Specialist reporting unit and the continued decline in the Company s stock price throughout the nine months ended September 30, 2004.

In testing for goodwill impairment, management determined the fair value of its equity, first by comparing the fair value of its Specialist reporting unit to its carrying value. The primary methods used to estimate the fair value of the Company s equity at September 30, 2004 included the use of an independent appraisal, various cash flow estimates and related discount rate assumptions, as well as the market capitalization of the Company. In its discounted cash flow analysis, the Company used certain estimates and assumptions to make financial projections, which incorporated the annualized operating results for the nine months ended September 30, 2004 as the base year. The operating results and cash flows for the annualized 2004 period took into account the aforementioned lower revenues. Based on these trends, the Company s earnings projections for the next eight years were revised. Since the result of this first comparison resulted in an excess of the Specialist reporting unit s carrying value over its fair value, the Company then estimated the implied fair value of goodwill of its Specialist reporting unit and

Table of Contents

compared it to its carrying value. Implied fair value of goodwill was determined by valuing all Specialist reporting unit assets and liabilities pursuant to the purchase accounting guidelines prescribed by SFAS No. 141, Business Combinations. The $37.6 million impairment charge represents the excess of Specialist reporting unit goodwill carrying value over its implied fair value. In accordance with SFAS 142, the Company will reassess its goodwill for impairment as of December 31, 2004, its annual impairment test date.

7. INCOME TAXES

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes, which requires the recognition of tax benefits or expenses based on the estimated future tax effects of temporary differences between the financial statement and tax bases of its assets and liabilities. Deferred tax assets and liabilities primarily relate to tax basis differences on non-marketable investments, stock-based compensation, other compensation accruals, amortization periods of certain intangibles and differences between the financial statement and tax bases of assets acquired.

The components of the provision (benefit) for income taxes reflected on the condensed consolidated statements of operations are set forth below (000 s omitted):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Current federal, state and local taxes	$ 14,073	$ (440)	$ (29,798)	$ 14,469
Deferred tax provision (benefit)	(15,606)	3,357	12,840	4,510
Total provision (benefit) for income taxes	$ (1,533)	$ 2,917	$ (16,958)	$ 18,979

8. CAPITAL AND NET LIQUID ASSET REQUIREMENTS

LaBranche & Co. LLC, as a specialist and member of the NYSE and AMEX, is subject to the provisions of SEC Rule 15c3-1, as adopted and administered by the SEC, NYSE and

AMEX. LaBranche & Co. LLC is required to maintain minimum net capital, as defined, equivalent to the greater of $100,000 or $^{1}/_{15}$ of aggregate indebtedness, as defined.

As of September 30, 2004 and December 31, 2003, LaBranche & Co. LLC s net capital, as defined under SEC Rule 15c3-1, was $460.4 million and $408.7 million, respectively, which exceeded the minimum requirements by $459.2 million and $403.1 million, respectively. LaBranche & Co. LLC s aggregate indebtedness to net capital ratio on those dates was .04 to 1 and .21 to 1, respectively.

The NYSE generally requires its specialist firms to maintain a minimum dollar regulatory capital amount in order to establish that they can meet, with their own net liquid assets, their position requirement. As of December 31, 2003, LaBranche & Co. LLC s NYSE minimum required dollar amount of net liquid assets, as defined, was $446.0 million, compared to actual net liquid assets, as defined, of $473.0 million. Due to the formation and commencement of operations of LSPS in July 2004, as of September 30, 2004, LaBranche & Co. LLC s and LSPS required combined dollar amount of net liquid assets, as defined, was increased to $447.0 million. LaBranche & Co. LLC s actual net liquid assets, as defined, was $460.3 million as of September 30, 2004. LSPS is not required to perform a net liquid assets calculation because LaBranche & Co. LLC s actual net liquid assets exceed the combined net liquid assets requirement of LaBranche & Co. LLC and LSPS.

The AMEX generally requires its equity specialist firms to maintain a cash or liquid asset position of the greater of (a) $1.0 million or (b) an amount sufficient to assume a position of sixty trading units of each security in which the equity specialist is registered. As of September 30, 2004, LaBranche & Co. LLC satisfied the AMEX equity specialist liquid asset requirements.

As a registered broker-dealer and member firm of the NYSE, LFSI is also subject to SEC Rule 15c3-1, as adopted and administered by the SEC and the NYSE. Under the alternative method permitted by this rule, the minimum required net capital is equal to the greater of $1.5 million or 2.0% of aggregate debit items, as defined. As of September 30, 2004 and December 31, 2003, LFSI s net capital, as defined, was $9.0 million and $14.4 million, respectively, which exceeded minimum requirements by $7.5 million and $12.9 million, respectively.

As a clearing broker-dealer, LFSI has elected to compute a reserve requirement for Proprietary Accounts of Introducing Broker-Dealers (PAIB Calculation), as defined. The PAIB Calculation is computed in order for correspondent firms to classify their assets held by LFSI as allowable assets in the correspondents net capital calculation. At September 30, 2004 there was no reserve requirement, and at December 31, 2003 the reserve requirement was $2.2 million. LFSI had cash and securities on deposit in a Special Reserve Bank Account of $4.5 million as of October 2, 2004 and $3.7 million as of January 5, 2004 to comply with its respective period-end requirements.

As a registered broker-dealer and AMEX member firm, LSP is subject to SEC Rule 15c3-1, as adopted and administered by the SEC and the AMEX. LSP is required to maintain minimum net capital, as defined, equivalent to the greater of $100,000 or $^{1}/_{15}$ of aggregate

Table of Contents

indebtedness, as defined. As of September 30, 2004 and December 31, 2003, LSP s net capital, as defined, was $22.0 million and $32.8 million, respectively, which exceeded minimum requirements by $21.7 million and $32.6 million, respectively.

LSPS, as a specialist and member of the NYSE, is subject to the provisions of SEC Rule 15c3-1, as adopted and administered by the SEC and NYSE. LSPS is required to maintain minimum net capital, as defined, equivalent to the greater of $100,000 or $^{1}/_{15}$ of aggregate indebtedness, as defined. As of September 30, 2004, LSPS net capital, as defined under SEC Rule 15c3-1, was $2.9 million, which exceeded the minimum requirements by $2.8 million. LSPS aggregate indebtedness to net capital ratio on those dates was .03 to 1.

9. EARNINGS (LOSS) PER SHARE

Earnings (loss) per share are computed in accordance with SFAS No. 128, Earnings Per Share. Basic earnings (loss) per share is calculated by dividing net income (loss) applicable to common stockholders by the weighted-average number of common shares outstanding. Diluted earnings (loss) per share includes the determinants of basic earnings (loss) per share and, in addition, gives effect to dilutive potential common shares for periods in which there is net income available to common shareholders.

The computations of basic and diluted earnings (loss) per share are set forth below (000 s omitted, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	**2003**	**2004**	**2003**
Net income (loss)	$ (36,462)	$ 3,212	$ (53,048)	$ 20,329
Less: preferred dividends and discount accretion	142	950	2,254	3,059
Numerator for basic and diluted earnings (loss) per share net income (loss) applicable to common stockholders	$ (36,604)	$ 2,262	$ (55,302)	$ 17,270
Denominator for basic earnings (loss) per share weighted-average number of common shares outstanding	59,926	59,649	59,852	59,557
Dilutive shares:				
Stock options		403		453
Restricted stock units		119		124
Denominator for diluted earnings (loss) per share weighted-average number of common shares outstanding	59,926	60,171	59,852	60,134
Basic earnings (loss) per share	$ (0.61)	$ 0.04	$ (0.92)	$ 0.29
Diluted earnings (loss) per share	$ (0.61)	$ 0.04	$ (0.92)	$ 0.29

The exercise prices for options to purchase an aggregate of 2,724,223 and 1,807,500 shares of common stock exceeded the average market price of the Company s common stock for the three and nine months ended September 30, 2004 and 2003, respectively. In addition, potential common shares relating to restricted stock and restricted stock units for the three months ended September 30, 2004 and 2003, totaling 552,960 and 182,246 shares, respectively, and for the nine months ended September 30, 2004 and 2003, totaling 484,094 and 177,541 shares, respectively, were antidilutive. The calculation of diluted earnings per share does not include the antidilutive effect of these stock-based awards. Dilutive potential common shares related to restricted stock units are not shown in the above table for the 2004 periods due to the net loss applicable to common stockholders for those periods.

10. EMPLOYEE INCENTIVE PLANS

In December 2002, the FASB issued SFAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, an Amendment of FASB Statement No. 123. SFAS No. 148 provides two additional methods, the modified prospective and the retroactive restatement methods, for an entity that voluntarily changes to the fair-value based method of accounting for stock-based employee compensation, in addition to the prospective method required by SFAS No. 123, Accounting for Stock-Based Compensation. Prior to January 1, 2003, the Company elected to account for stock based employee compensation in accordance with Accounting Principles Board Opinion (APB) No. 25 as permitted by SFAS No. 123. In accordance with APB No. 25, compensation expense was not recognized for stock options that had no intrinsic value on the date of grant. In addition, compensation expense was not recognized for those options issued in connection with the Company s acquisition of ROBB PECK McCOOEY Financial Services, Inc. (RPM) in March 2001 and treated as part of the purchase price of RPM in accordance with the rules of purchase accounting. On January 1, 2003, the Company adopted the prospective method provided by SFAS No. 148 to account for stock-based employee compensation. Accordingly, the Company expenses the fair value, as of the date of grant, of stock options issued to employees on or after January 1, 2003 over the related service periods. The Company has not issued any stock options since January 1, 2003.

Table of Contents

If the Company had recognized compensation expense for options granted prior to January 1, 2003 under the fair-value based method of SFAS No. 123, net income (loss) applicable to common stockholders and earnings (loss) per share would have been reduced to the pro forma amounts indicated below:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(000 s omitted, except per share data)	2004	2003	2004	2003
Net income (loss) applicable to common stockholders, as reported	$ (36,604)	$ 2,262	$ (55,302)	$ 17,270
Add: Stock-based compensation expense included in reported net income (loss) (net of tax effect)	420	431	1,584	1,359
Less: Stock-based compensation expense under SFAS 123 (net of tax effect)	(1,672)	(2,206)	(5,704)	(6,720)
Pro forma net income (loss) applicable to common stockholders	$ (37,856)	$ 487	$ (59,422)	$ 11,909
Diluted earnings (loss) per share, as reported	$ (0.61)	$ 0.04	$ (0.92)	$ 0.29
Diluted earnings (loss) per share, pro forma	$ (0.63)	$ 0.01	$ (0.99)	$ 0.20

The effect of applying SFAS No. 123 in the pro forma disclosure above may not be representative of the potential effect stock-based compensation would have on net income in future periods.

11. BUSINESS SEGMENTS

Segment information is presented in accordance with SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information. Prior to January 1, 2002, the Company considered its operations to be one reportable segment for purposes of presenting consolidated financial information and evaluating its performance. Since adopting SFAS No. 131 in 2002, the Company views its business as two separate segments: (a) Specialist and (b) Execution and Clearing. The Company s business segments are based on the nature of the financial services provided, their revenue source and the Company s management organization.

The Company s Specialist segment operates as a specialist in equities, rights and ETFs listed on the NYSE, as a specialist in equities, options, ETFs and futures on the AMEX, NYBOT and PHLX and as a market-maker in options, ETFs and futures on several exchanges. The Specialist segment currently includes the operations of LaBranche & Co. LLC, LSP, LSPS, LABDR and BV.

The Company s Execution and Clearing segment provides securities execution, securities clearing and other related services to its own retail customers, customers of introducing brokers and institutional customers, including traders, professional investors and broker-dealers. This segment also provides direct-access floor brokerage services to institutional customers. The Execution and Clearing segment currently includes the operations of LFSI.

Revenues and expenses directly associated with each segment are included in determining its operating results. Other expenses, including corporate overhead, which are not directly attributable to a particular segment, generally are allocated to each segment based on its resource usage levels or other appropriate measures. Certain administrative expenses,

-13-

Table of Contents

corporate overhead expenses and other sources of revenue are not specifically allocated by management when reviewing the Company s segments performance, and appear in the Other section. Selected financial information for each segment is set forth below (000 s omitted):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2004	2003	2004	2003
Specialist Segment:				
Revenues	$ 53,532	$ 58,218	$ 174,305	$ 197,591
Operating expenses	33,324	34,681	98,537	101,385
Goodwill impairment	37,600		37,600	
Exchange memberships impairment			16,300	
Depreciation and amortization expense	2,916	2,917	8,728	8,796
Income (loss) before minority interest and taxes	(20,308)	20,620	13,140	87,410
Segment goodwill	251,993	466,485	251,993	466,485
Segment assets	2,020,902	1,894,260	2,020,902	1,894,260
Execution and Clearing Segment:				
Revenues	$ 10,594	$ 11,758	$ 35,405	$ 36,159
Operating expenses	11,892	13,259	39,319	43,147
Exchange memberships impairment			2,027	
Depreciation and amortization expense	115	176	359	865
Loss before minority interest and taxes	(1,413)	(1,677)	(6,300)	(7,853)
Segment goodwill		4,051		4,051
Segment assets	53,897	86,704	53,897	86,704
Other (1):				
Revenues	$ 534	$ 928	$ 25,565	$ 1,292
Operating expenses	16,621	13,540	52,778	41,191
Debt repurchase premium			49,028	
Depreciation and amortization expense	26	35	75	56
Loss before minority interest and taxes	(16,113)	(12,647)	(76,316)	(39,955)
Segment assets	147,677	91,655	147,677	91,655
Total:				
Revenues	$ 64,660	$ 70,904	$ 235,275	$ 235,042
Operating expenses	61,837	61,480	190,634	185,723
Goodwill impairment	37,600		37,600	
Exchange memberships impairment			18,327	
Debt repurchase premium			49,028	
Depreciation and amortization expense	3,057	3,128	9,162	9,717
Income (loss) before minority interest and taxes	(37,834)	6,296	(69,476)	39,602
Goodwill	251,993	470,536	251,993	470,536
Assets	$ 2,222,476	$ 2,072,619	$ 2,222,476	$ 2,072,619

(1) *Other* is comprised primarily of the interest on the Holding Company s indebtedness, unallocated corporate administrative expenses, including legal costs, unallocated revenues (primarily net gains and losses from non-marketable investments and interest income) and elimination entries.

Table of Contents

12. COMMITMENTS AND CONTINGENCIES

There have been no material new developments in the Company s legal proceedings since the filing on August 9, 2004 of the Company s Form 10-Q for the quarter ended June 30, 2004 (the Second Quarter 10-Q), which updated the legal proceedings disclosed in the 2003 10-K and the Form 10-Q for the quarter ended March 31, 2004 (the First Quarter 10-Q), except as follows:

On October 5, 2004, the court in the Northern District of Illinois lawsuit described in the 2003 10-K (Last Atlantis Capital LLC v. Chicago Board of Options Exchange, Inc., et al., Civ. No. 04 C 0397) vacated the February 14, 2005 trial date it had previously set.

On November 8, 2004, the Brown case described in the 2003 10-K was dismissed without prejudice.

The Company believes that the claims asserted against it in the above lawsuit and in the others described in the 2003 10-K, the First Quarter 10-Q and the Second Quarter 10-Q are without merit, and the Company denies all allegations of wrongdoing. There can be no assurance, however, as to the outcome or timing of the resolution of these proceedings. The Company therefore is unable to estimate the amount or potential range of any loss that may arise out of these proceedings. The range of possible resolutions could include determinations and judgments against the Company or settlements and could require substantial payments by the Company that could have a material adverse effect on the Company s financial condition, results of operations and cash flows.

The Company has been the target, from time to time, of various other claims and lawsuits incidental to the ordinary course of its business operations. While the ultimate outcome of those claims and lawsuits which currently are pending cannot be predicted with certainty, the Company believes, based on its understanding of the facts of these proceedings, that their ultimate resolution will not, in the aggregate, have a material adverse effect on the Company s financial condition or results of operations.

13. SUBSEQUENT EVENTS

On September 10, 2004, pursuant to a registration rights agreement between the Company and the initial purchaser of the Original Senior Notes, the Company offered to exchange (i) its 9.5% Senior Notes due 2009 that have been registered under the Securities Act (the 2009 Senior Notes) for an equal principal amount of Original 2009 Notes and (ii) its 11.0% Senior Notes due 2012 that have been registered under the Securities Act (the 2012 Senior Notes, and together with the 2009 Senior Notes, the Senior Notes) for an equal principal amount of Original 2012 Notes.

The exchange offer expired on October 22, 2004, with the holders of 98.5%, or $197.0 million aggregate principal amount, of the Original 2009 Notes having tendered their Original 2009 Notes for exchange, and the holders of 100.0%, or $260.0 million aggregate principal amount, of the Original 2012 Notes having tendered their Original 2012 Notes for exchange. The Senior Notes are substantially identical to the Original Senior Notes, except that the Senior Notes have been registered under the Securities Act and do not bear any legend restricting their transfer. The Senior Notes represent the same indebtedness as the Original Senior Notes and have been issued under the same indenture. All subsequent references to the term 2009 Senior Notes shall be deemed to include the $3.0 million principal amount of Original 2009 Notes that were not tendered in the exchange offer and remain outstanding.

Table of Contents

Pursuant to the indenture governing the Senior Notes, to the extent the Company did not use the net proceeds of the sale of the Original Senior Notes to repurchase Old Notes in connection with the Company s May 2004 debt refinancing, repurchase the outstanding shares of the Company s Series B preferred stock before September 15, 2004 and pay related fees and expenses, the Company is required to use such excess proceeds to offer to repurchase an equal principal amount of Senior Notes at a price of 101.0%, on a pro rata basis. On November 1, 2004, the Company commenced an offer to purchase for cash from all holders of Senior Notes, on a pro rata basis, approximately $18.2 million aggregate principal amount of Senior Notes (which is the amount of the excess proceeds) at a price equal to 101.0% of the principal amount of the Senior Notes to be purchased, plus accrued and unpaid interest, if any, up to, but not including, the date of purchase. This excess proceeds offer is scheduled to expire on December 1, 2004, unless extended by the Company. In the event the Company receives tenders for at least the full $18.2 million principal amount of Senior Notes, the total amount of funds required by the Company to purchase tendered Senior Notes, before accrued and unpaid interest, will be approximately $18.4 million, including the 1.0% premium.

Table of Contents

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

Unless the context otherwise requires, the Company or we shall mean LaBranche & Co Inc. and its wholly-owned subsidiaries.

This discussion should be read in conjunction with the Company s Condensed Consolidated Financial Statements and the Notes thereto contained in this report.

Executive Overview

For the third quarter of 2004, we reported a loss of $36.6 million, or $0.61 per share. Excluding a non-cash goodwill impairment charge of $37.6 million and a $0.5 million after-tax charge attributable to the repurchase of our Series B preferred stock in July 2004, our operating loss was $0.6 million, or $0.01 per share. The key drivers for these results included declining quarter over quarter share volumes for stocks in which we are the specialist, lower market volatility and the increasing rate of program trading as a percentage of total volume on the NYSE. These declines resulted in our specialists having fewer opportunities to commit our capital for principal trades.

Although principal trading revenue at our LaBranche & Co. LLC subsidiary was lower in the third quarter and nine months of 2004 than in the comparable 2003 periods, our LSP subsidiary has continued to grow through expansion into new marketplaces and diversification of its product offerings. We are adapting to continuing poor market conditions this year through improving operational efficiencies, reducing headcount and related operating expenses and further enhancing our compliance and trading systems. We believe these changes streamline our organization without sacrificing our ability to respond to developments in the equity market environment. However, due to the NYSE s proposed changes in its automated trade execution system and the continued uncertainty surrounding the SEC s proposed market structure changes, we are unable to predict whether our NYSE specialist trading revenues in future periods will be adversely affected.

In terms of liquidity, during the first nine months of 2004, we successfully completed a refinancing of certain of our indebtedness by repurchasing a substantial portion of our then-outstanding senior and senior subordinated notes and issuing $460.0 million aggregate principal amount of 9.5% senior notes due 2009 (the Original 2009 Notes) and 11.0% senior notes due 2012 (the Original 2012 Notes and collectively with the Original 2009 Notes, the Original Senior Notes). Although this refinancing increased the aggregate principal amount of our outstanding indebtedness, the interest rates on our newly issued Senior Notes and the third-quarter repurchase of all our remaining shares of Series B preferred stock have enabled us to extend the maturities of our debt without increasing the combination of our overall after-tax annual interest and dividends expense.

Table of Contents

On March 29, 2004, we entered into an agreement with the NYSE and the SEC to settle their investigations concerning our NYSE specialist trading activity. This settlement resolved the NYSE and the SEC investigations of our NYSE specialist trading activity for all periods through 2003. As part of the settlement with the NYSE and the SEC, we have agreed to comply with the following undertakings:

implementation of systems and procedures to ensure appropriate follow-up and review with regard to information provided to LaBranche & Co. LLC on a daily basis by the NYSE with regard to specialists override of the Principal Inhibitor function, which identifies specialist principal trades that may have been effected while an executable agency order was reflected in the order book on the same side of the market;

creation of a committee, including LaBranche & Co. LLC s chief compliance officer and at least two members of senior management, specifically charged with meeting periodically (no less frequently than monthly) to evaluate specialist rule compliance;

development and/or enhancement of systems and procedures to track and maintain records identifying the individuals acting as specialist and clerk for each security at all times throughout each trading day;

annual certification, through LaBranche & Co. LLC s chief executive officer, that a review has been conducted by the chief compliance officer of trading in LaBranche & Co. LLC s principal account for the purpose of detecting interpositioning, trading ahead and unexecuted limit order violations;

bi-annual assessment of, and reports on, the adequacy of the resources devoted to LaBranche & Co. LLC s compliance function, and devotion of adequate funds and staffing to the compliance department; and

retention of an independent consultant to review and evaluate LaBranche & Co. LLC s compliance systems, policies and procedures reasonably designed to ensure that LaBranche & Co. LLC is in compliance with federal securities laws and NYSE rules with regard to specialist trading.

We are complying with these undertakings and do not expect these changes or enhancements to adversely affect our principal trading revenues. Instead, our fulfillment of these undertakings should enhance our risk management activities related to our specialist trading activity.

New Accounting Developments

In December 2003, the FASB issued FIN 46(R), Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. FIN 46(R) requires a company to consolidate a variable interest entity (VIE) if the company has variable interests that give it a majority of the expected losses or a majority of the expected residual returns, or both, of the entity. FIN 46(R) was effective no later than the end of the first reporting period that ends after March 15, 2004. As of September 30, 2004 we have determined that none of our investments are considered a VIE under the guidance provided in FIN 46(R), and therefore, the implementation of FIN 46(R) has had no impact on our consolidated financial statements.

Critical Accounting Estimates

Goodwill and Other Intangible Assets

We determine the fair value of each of our reporting units and the fair value of each reporting unit s goodwill under the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. In determining fair value, we use standard analytical approaches to business enterprise valuation (BEV), such as the market comparable approach and the income approach. The market comparable approach is based on comparisons of the subject company to similar companies engaged in an actual merger or acquisition or to public companies whose stocks are actively traded. As part of this process, multiples of value relative to financial variables, such as earnings or stockholders equity, are developed and applied to the appropriate financial variables of the subject company to indicate its value. The income approach involves estimating the present value of the subject company s future cash flows by using projections of the cash flows that the business is expected to generate, and discounting these cash flows at a given rate of return. Each of these BEV methodologies requires the use of management estimates and assumptions. For example, under the market comparable approach, we assigned a certain control premium to the average public market price of our common stock during the third quarter of 2004 in estimating the fair value of our specialist reporting unit. Similarly, under the income approach, we assumed certain growth rates for our revenues, expenses, earnings before interest, depreciation and amortization, income taxes, returns on working capital, returns on other assets and capital expenditures, among others. We also assumed a certain discount rate and certain terminal growth rates in our calculations. For our third quarter 2004 goodwill impairment test, we engaged an independent business valuation firm to assist us in our BEV analysis. Given the subjectivity involved in selecting which BEV approach to use and in determining the input variables for use in our analyses, it is possible that a different valuation model and the selection of different input variables could produce a materially different estimate of fair value.

We review the reasonableness of the carrying value of our goodwill on an annual calendar basis (i.e., December 31) unless an event or change in circumstances would require an interim reassessment of impairment. During the nine months ended September 30, 2004, certain changes in circumstances occurred that necessitated goodwill impairment testing. The two primary factors we analyzed, which indicated a need for us to reassess the reasonableness of the carrying value of our goodwill at September 30, 2004, were the prolonged downward trend in the principal trading revenues at our Specialist reporting unit and the continued decline in the public trading price of shares of our common stock. In our third quarter 2004 SFAS No. 142 test, we compared the fair value of our Specialist reporting unit and the fair value of our Specialist reporting unit s goodwill based on the methods described above to their respective carrying values in two separate steps under SFAS No. 142 guidelines to arrive at the $37.6 million impairment charge we recognized during the 2004 fiscal third quarter. Despite our interim valuation of goodwill as of September 30, 2004, SFAS No. 142 requires us to test goodwill on an annual calendar basis. Accordingly, we will update our valuation models through and including our annual testing date, or December 31, 2004. We can provide no assurance that any future goodwill impairment testing will not result in goodwill impairment charges for the remainder of our 2004 fiscal year or in subsequent periods.

Our other intangible asset, as defined under SFAS No. 142, is our trade name. We determine the fair value of our trade name by applying the income approach using the royalty savings methodology. This method assumes that the trade name has value to the extent we are relieved of the obligation to pay royalties for the benefits received from it. Application of this methodology requires estimating an appropriate royalty rate, which is typically expressed as a percentage of revenue. Estimating an appropriate royalty rate includes reviewing evidence from comparable licensing agreements and considering qualitative factors affecting the trade name.

We review the reasonableness of the carrying amount of our trade name on an annual basis in conjunction with our goodwill impairment assessment. As of September 30, 2004, the fair value of our trade name determined in accordance with the methodology described above exceeded its carrying amount. Therefore, no impairment of our trade name existed at September 30, 2004. We can provide no assurance that any future trade name impairment testing will not result in trade name impairment charges for the remainder of our 2004 fiscal year or in subsequent periods.

Given the subjectivity involved in selecting which BEV approach to use and in determining the input variables for use in our analyses, it is possible that a different valuation model and the selection of different input variables could produce a materially different estimate of fair value of our goodwill and trade name.

Non-Marketable Securities

The use of fair value to measure certain non-marketable investments is a critical accounting estimate. Investments in non-marketable securities consist of investments in equity securities of private companies, limited liability company interests and limited partnership interests, which do not have readily available price quotations. Certain investments in non-marketable securities are initially carried at cost as an approximation of fair value. Adjustments to carrying value are made if there are third-party transactions evidencing a change in value. For certain other investments in non-marketable securities, we adjust their carrying value by applying the equity method of accounting, and for our investment in a limited partnership interest, we adjust its carrying value by recognizing our share of the partnership s quarterly results of operations. In addition, if and when available, management considers other factors relating to non-marketable investments in estimating their fair value, such as the financial performance of the entity, its cash flow forecasts, trends within that entity s industry and any specific rights associated with our investment, such as conversion features.

Given management s judgment involved in valuing certain of our non-marketable securities, it is possible, as of a given point in time, that a third-party could reach a different conclusion of fair value utilizing the same variables as we have in our analysis.

Other-Than-Temporary Impairment of Exchange Memberships

The determination of the fair value of our exchange memberships is a critical accounting estimate. Exchange memberships owned by us are originally carried at cost, pursuant to the American Institute of Certified Public Accountants (AICPA) *Audit and Accounting Guide Brokers and Dealers in Securities*. Adjustments to carrying value are made if we deem that an other-than-temporary decline in value, as defined in Emerging Issues Task Force (EITF) Issue No. 03-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* has occurred. In determining whether

Table of Contents

the value of the exchange memberships we own is impaired (*i.e*., fair market value is below cost) and whether such impairment is temporary or other-than-temporary, we consider many factors, including, but not limited to, information regarding recent sale and lease prices of exchange memberships, historical trends of sale and lease prices of memberships on a particular exchange and their duration, the current condition of the particular exchange s market structure, legal and regulatory developments affecting the particular exchange s market structure and earnings capability, trends in new listings on the particular exchange, general global and national economic factors and our knowledge and judgment of the specialist industry and the securities market as a whole.

As a result of our analysis of the above-mentioned factors for the quarter ended September 30, 2004, the difference between the fair value of our NYSE exchange memberships and their carrying value at September 30, 2004 is deemed temporary. We previously recorded an other-than-temporary impairment charge of $18.3 million to reduce the carrying value (or cost basis) of our NYSE exchange memberships during the second quarter of 2004.

We can provide no assurance that the consistent application of this accounting policy to future reporting periods will not result in further adjustments to the carrying value of our NYSE memberships.

May 2004 Refinancing of Our Indebtedness

On May 18, 2004, in connection with the refinancing of certain of our indebtedness, we repurchased approximately $93.1 million of our then-outstanding $100.0 million aggregate principal amount 9.5% senior notes due 2004 (the 2004 Notes) and approximately $236.4 million of our then-outstanding $250.0 million aggregate principal amount 12.0% senior subordinated notes due 2007 (the 2007 Notes and, together with the 2004 Notes, the Old Notes), and paid for related consents delivered by the holders of the Old Notes on or prior to April 19, 2004. The aggregate purchase price we paid for the Old Notes was approximately $386.9 million, which included the purchase price, premium and consent payments of approximately $49.0 million and accrued but unpaid interest on the Old Notes up to, but not including, the settlement date. Upon the completion of this refinancing, the indentures governing the remaining outstanding Old Notes were stripped of substantially all restrictive covenants, certain events of default and other related provisions.

In order to fund the repurchase of the Old Notes, we issued the Original 2009 Notes in the aggregate principal amount of $200.0 million and the Original 2012 Notes in the aggregate principal amount of $260.0 million. The indenture governing the Original Senior Notes contains provisions similar to the indentures that governed the Old Notes prior to their amendment. For a more complete description of the restrictive covenants in the indenture governing the Original Senior Notes, please see Liquidity and Capital Resources.

In connection with our purchase of the Old Notes and our payment for the related consents that were delivered on or prior to April 19, 2004, we recorded a charge of approximately $55.9 million in the second quarter of 2004 for premium and consent payments, accelerated debt issuance cost amortization and discount accretion and other related fees. In connection with the issuance of the Original Senior Notes, we capitalized certain costs in the aggregate amount of approximately $12.7 million, and are amortizing these costs over the life of these notes.

Repayment of Remaining 2004 Notes

On August 16, 2004, we repaid the $6.9 million aggregate principal amount of 2004 Notes that remained outstanding after our May 2004 refinancing, plus all accrued but unpaid interest thereon, for an aggregate of $7.2 million. No 2004 Notes remain outstanding and the indenture governing the 2004 Notes was terminated.

Completed Exchange Offer

On September 10, 2004, pursuant to a registration rights agreement between the initial purchaser of the Original Senior Notes and us, we offered to exchange (i) our 9.5% Senior Notes due 2009 that have been registered under the Securities Act of 1933, as amended (the 2009 Senior Notes), for an equal principal amount of outstanding Original 2009 Notes and (ii) our 11.0% Senior Notes due 2012 that have been registered under the Securities Act, as amended (the 2012 Senior Notes, and together with the 2009 Senior Notes, the Senior Notes), for an equal principal amount of outstanding Original 2012 Notes.

The exchange offer expired on October 22, 2004, with the holders of 98.5%, or $197.0 million aggregate principal amount, of Original 2009 Notes having tendered their Original 2009 Notes for exchange, and the holders of 100.0%, or $260.0 million aggregate principal amount, of the Original 2012 Notes having tendered their Original 2012 Notes for exchange. The new Senior Notes represent the same indebtedness as the Original Senior Notes that were exchanged and have been issued under the same indenture. All subsequent references in this Report to the term 2009 Senior Notes shall include the $3.0 million principal amount of Original 2009 Notes that were not tendered in the exchange offer and remain outstanding.

Results of Operations

Specialist Segment Operating Results

(000 s omitted)	For the Three Months Ended September 30, 2004	For the Three Months Ended September 30, 2003	For the Nine Months Ended September 30, 2004	For the Nine Months Ended September 30, 2003	Three Months 2004 vs. 2003 Percentage Change	Nine Months 2004 vs. 2003 Percentage Change
Revenues:						
Net gain on principal transactions	$ 38,997	$ 45,019	$ 131,740	$ 157,013	(13.4)%	(16.1)%
Commissions	11,612	11,678	36,430	35,309	(0.6)	3.2
Other	2,923	1,521	6,135	5,269	92.2	16.4

Total segment revenues	53,532	58,218	174,305	197,591	(8.0)	(11.8)
Goodwill impairment	37,600		37,600			
Exchange memberships impairment			16,300			
Operating expenses	36,240	37,598	107,265	110,181	(3.6)	(2.6)
Income (loss) before minority interest and taxes	$ (20,308)	$ 20,620	$ 13,140	$ 87,410	(198.5)	(85.0)

Table of Contents

Revenues from our Specialist segment consist primarily of net gain on principal transactions in securities for which we act as specialist. Net gain on principal transactions represents trading gains net of trading losses and SEC transaction fees, where applicable, and are earned by us when we act as principal buying and selling our specialist stocks, rights, options, ETFs and futures. Also included in net gain on principal transactions are accrued dividends receivable or payable on our stock positions, net gains and losses resulting from our market-making activities in ETFs, options and futures, and net gains and losses resulting from trading of foreign currencies, futures, equities and U.S. Government obligations underlying the rights, ETFs and options for which we act as specialist or market-maker. These revenues are primarily affected by changes in share volume traded and fluctuations in the price of our stocks, options, ETFs and futures in which we are the specialist or in which we make a market.

Commissions revenue generated by our Specialist segment consists primarily of fees earned when our specialists act as agents by executing limit orders in equities on behalf of brokers, professional traders and broker-dealers after a specified period of time; we do not earn commissions in equities when we match market orders or when we act as a specialist or a market-maker in other products.

Other revenue at our Specialist segment consists primarily of interest income, proprietary trading gains or losses and gains or losses from an investment in a hedge fund.

When assessing the performance and financial results of our NYSE specialist operations for a specific period, management examines certain metrics to determine their impact on financial results. Some of the key metrics that management reviews and their values for the three and nine month periods ended September 30, 2004 and 2003 were as follows:

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,		Three Months 2004 vs. 2003 Percentage	Nine Months 2004 vs. 2003 Percentage
	2004	2003	2004	2003	Change	Change
NYSE average daily share volume (in millions)	1,326.6	1,364.1	1,440.8	1,419.5	(2.7)%	1.5%
LAB share volume on the NYSE (in billions)	22.1	23.1	71.3	71.4	(4.3)	(0.1)
LAB dollar value on the NYSE (in billions)	$ 636.3	$ 626.7	$ 2,076.0	$ 1,837.1	1.5	13.0
Share volume of principal shares traded (in billions)	4.9	6.5	16.8	21.6	(24.6)	(22.2)
Dollar value of principal shares traded (in billions)	$ 148.6	$ 176.2	$ 512.9	$ 555.9	(15.7)	(7.7)
Average closing price of the CBOE Volatility Index	15.4	20.9	16.1	26.2	(26.3)	(38.5)
Program trading as an approximate percentage of NYSE average daily share volume [1]	54.0%	40.5%	49.5%	39.0%		

(1) The program trading percentage is determined using the average of weekly percentages throughout the appropriate time periods. Due to the weekly nature of our source data, the values indicated do not exactly coincide with our three-month and nine-month reporting periods.

Table of Contents

Generally, an increase in the average daily share volume on the NYSE, an increase in volatility (as measured by the average closing price of the Chicago Board of Options Exchange s Volatility Index®, or the VIX) or an increase in the dollar value and share volume of stocks in which specialists trade, enables the specialist to increase its level of principal participation and thus its ability to realize net gain on principal transactions. While we monitor these metrics each period, they are not the sole indicators or factors that determine our level of revenues, profitability or overall performance in any given period. Other factors, such as extreme price movements, unanticipated listed company news and events and other uncertainties may influence our financial performance either positively or negatively.

Three Months Ended September 30, 2004 Compared to Three Months Ended September 30, 2003

The decline in specialist trading revenues at our LaBranche & Co. LLC subsidiary to $31.4 million for the three months ended September 30, 2004 from $40.4 million for the same period in 2003 can be attributed to the reduced opportunity to trade profitably as principal as evidenced by the significant decline in principal shares traded, a result of the decrease in share volume for stocks in which we are the specialist as well as a decline in market volatility, as measured by the average closing price of the VIX. Another factor that has reduced the opportunity for the specialists to participate is the continuing rise in program trading as a percentage of NYSE average daily share volume. Program trading involves reducing large share orders into many smaller orders, resulting in the orders being matched electronically. Net gain on principal transactions generated by our LSP and LSPS subsidiaries increased to $7.6 million for the third quarter of 2004 as compared to $4.6 million for the same period in 2003. This revenue growth was a result of increases in the number of traders, products traded, trading volume and the expansion of trading activity to additional exchanges.

For a discussion of operating expenses, see Our Operating Expenses below.

Nine Months Ended September 30, 2004 Compared to Nine Months Ended September 30, 2003

The decline in specialist trading revenues at our LaBranche & Co. LLC subsidiary to $108.7 million for the nine months ended September 30, 2004 from $145.4 million for the same period in 2003 was the result of the decrease in principal shares traded, which can be attributed to the significant decline in market volatility, as measured by the average closing price of the VIX, which reduces our opportunity to trade profitably as principal. Another factor that has reduced our NYSE equity specialist s principal trading revenues is the continuing rise in program trading. Program trading involves reducing large share orders into many smaller orders, resulting in the orders being matched electronically, and reducing the opportunity for specialists to participate. Net gain on principal transactions generated by our LSP and LSPS

Table of Contents

subsidiaries increased to $23.0 million for the nine months ended September 30, 2004, compared to $11.6 million for the same period in 2003. This revenue growth was the result of the rea