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LABRANCHE & CO INC  
Form 10-K  
March 15, 2002

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

FORM 10-K

Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended DECEMBER 31, 2001

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  
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LaBRANCHE & CO INC.  
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(Exact Name of Registrant as Specified in Its Charter)

DELAWARE  
-----

13-4064735  
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(State or Other Jurisdiction of  
Incorporation or Organization)

(I.R.S. Employer  
Identification No.)

ONE EXCHANGE PLAZA, NEW YORK, NEW YORK 10006  
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(Address of Principal Executive Offices) (Zip Code)

(212) 425-1144  
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(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act: Common Stock, par value \$0.01 New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

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

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the registrant, based upon the last sale price of the Common Stock reported on the New York Stock Exchange on March 14, 2002, was approximately \$622,000,000.

The number of shares of Common Stock outstanding as of March 14, 2002 was 59,116,678.

### DOCUMENTS INCORPORATED BY REFERENCE

As stated in Part III of this Annual Report on Form 10-K, portions of the registrant's definitive proxy statement for the registrant's 2002 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

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### PART I

THIS ANNUAL REPORT ON FORM 10-K AND THE DOCUMENTS INCORPORATED BY REFERENCE CONTAIN FORWARD-LOOKING STATEMENTS THAT HAVE BEEN MADE PURSUANT TO THE PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995. THESE FORWARD-LOOKING STATEMENTS ARE BASED ON CURRENT EXPECTATIONS, ESTIMATES AND PROJECTIONS ABOUT THE REGISTRANT'S INDUSTRY, MANAGEMENT'S BELIEFS AND CERTAIN ASSUMPTIONS MADE BY MANAGEMENT. WORDS SUCH AS "ANTICIPATES," "EXPECTS," "INTENDS," "PLANS," "BELIEVES," "SEEKS," "ESTIMATES," VARIATIONS OF SUCH WORDS AND SIMILAR EXPRESSIONS ARE INTENDED TO IDENTIFY SUCH FORWARD-LOOKING STATEMENTS. THESE STATEMENTS ARE NOT GUARANTEES OF FUTURE PERFORMANCE AND ARE SUBJECT TO CERTAIN RISKS, UNCERTAINTIES AND ASSUMPTIONS THAT ARE DIFFICULT TO PREDICT; THEREFORE, ACTUAL RESULTS MAY DIFFER MATERIALLY FROM THOSE EXPRESSED OR FORECASTED IN ANY SUCH FORWARD-LOOKING STATEMENTS. UNLESS REQUIRED BY LAW, THE REGISTRANT UNDERTAKES NO OBLIGATION TO UPDATE PUBLICLY ANY FORWARD-LOOKING STATEMENTS, WHETHER AS A RESULT OF NEW INFORMATION, FUTURE EVENTS OR OTHERWISE. HOWEVER, READERS SHOULD CAREFULLY REVIEW THE RISK FACTORS SET FORTH IN OTHER REPORTS OR DOCUMENTS THE REGISTRANT FILES FROM TIME TO TIME WITH THE SECURITIES AND EXCHANGE COMMISSION.

#### ITEM 1. BUSINESS.

##### OVERVIEW

LaBranche & Co Inc. ("LaBranche") is a holding company that is the sole member of LaBranche & Co. LLC and owns all the outstanding stock of LaBranche Financial Services, Inc. ("LFSI"). Founded in 1924, LaBranche & Co. LLC is one of the oldest and largest specialist firms on the New York Stock Exchange ("NYSE"). We also act as a specialist in stocks and options on the American Stock Exchange ("AMEX"). Our LFSI subsidiary is a clearing broker for customers of introducing brokers and provides direct access floor brokerage services to institutional customers, securities clearing and other related services to individual and institutional clients, including traders, professional investors and broker-dealers. In addition, LFSI also provides front-end order execution, analysis and reporting solutions for the wholesale securities dealer market. As of December 31, 2001, our former subsidiaries Henderson Brothers, Inc. ("Henderson Brothers") and Internet Trading Technologies, Inc. ("ITTI") were merged with and into our ROBB PECK McCOOEY Clearing Corporation subsidiary ("RPM Clearing Corporation"). RPM Clearing Corporation changed its name to LFSI in January 2002 and continues to be a registered broker-dealer and NYSE member firm.

As a specialist, our role is to maintain, as far as practicable, a fair and orderly market in our specialist stocks. In doing so, we provide a service to our listed companies, and to the brokers, traders and investors who trade in

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our specialist stocks. We believe that, as a result of our commitment to providing high quality specialist services, we have developed a strong reputation among our constituencies, including investors, members of the Wall Street community and our listed companies.

Our business has grown considerably during the past five years. Our revenues have increased from approximately \$49.9 million in 1996 to \$424.1 million in 2001, representing a compound annual growth rate of 53.4%. We have accomplished our growth both internally and

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through acquisitions. For example, since the NYSE implemented its new specialist allocation process in March 1997, as described in "Industry Background-The NYSE Specialist," we have been selected by 87 new listed companies, resulting from 178 listing interviews through December 31, 2001. In addition, we have acquired ten specialist operations since 1997, adding over 550 NYSE and AMEX common stocks and 107 AMEX-listed options for which we act as the specialist. During the past five years, we have also increased the scope of our business, as illustrated by the following data:

- o the annual dollar volume on the NYSE of stocks for which we acted as specialist increased to \$2.5 trillion in 2001, from \$201.4 billion in 1996. Based on these dollar volumes, we were the largest specialist firm in 2001 as compared to the sixth largest in 1996;
- o the annual share volume on the NYSE of stocks for which we act as specialist increased to 76.0 billion in 2001, from 5.6 billion in 1996. Based on these share volumes, we were the largest specialist firm in 2001 as compared to the fourth largest in 1996; and
- o the total number of our common stock listings increased to 591 as of December 31, 2001, from 132 as of December 31, 1996. Based on the number of our NYSE common stock listings, we were the largest specialist firm as of December 31, 2001 as compared to the fourth largest as of December 31, 1996. In addition, we acted as the specialist for 266 other NYSE-listed securities (e.g., preferred and convertible securities) and for 57 stocks and 122 options on AMEX.

As of December 31, 2001, our listed companies included:

- o 104 of the S&P 500 Index companies; and
- o nine of the 30 companies comprising the Dow Jones Industrial Average. Our Dow stocks are American Express Company, AT&T, DuPont, Eastman Kodak, ExxonMobil, Merck, Minnesota Mining & Manufacturing, Philip Morris and SBC Communications.

### INDUSTRY BACKGROUND

#### THE NYSE

The NYSE is currently the largest securities market in the world. The market capitalization of all U.S. shares listed on the NYSE increased from approximately \$6.8 trillion at December 31, 1996 to approximately \$11.9 trillion at December 31, 2001, representing a compound annual growth rate of 11.8%.

The NYSE's average daily trading volume increased from 178.9 million shares in 1991 to 1.2 billion shares in 2001, as illustrated by the following graph:

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### NYSE AVERAGE DAILY TRADING VOLUME FROM 1991 TO 2001 (SHARE VOLUME IN MILLIONS)

EDGAR REPRESENTATION OF DATA POINTS USED IN PRINTED GRAPHIC

|      |      |
|------|------|
| 1991 | 179  |
| 1992 | 202  |
| 1993 | 265  |
| 1994 | 291  |
| 1995 | 346  |
| 1996 | 412  |
| 1997 | 527  |
| 1998 | 674  |
| 1999 | 809  |
| 2000 | 1042 |
| 2001 | 1240 |

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Trading on the NYSE takes place through open bids to buy and open offers to sell made by NYSE members, acting as principal or as agent for institutions or individual investors. Buy and sell orders meet directly on the trading floor through an auction process, and prices are determined by the interplay of supply and demand in that auction. In order to buy and sell securities on the NYSE, a person must first be accepted for membership in the NYSE. The number of memberships, or seats, is presently limited to 1,366, and the price of a membership depends on supply and demand. Based on recent transfers of memberships, the market price of a membership on the NYSE is approximately \$2.2 million as of February 28, 2002. To become a member, each prospective applicant must also pass an examination covering NYSE rules and regulations.

NYSE members are generally categorized based upon the activities in which they engage on the trading floor, such as specialists or brokers. The largest single membership group is floor brokers, which consists of both commission brokers and independent brokers. Commission brokers are employed by broker-dealer firms that are members of the NYSE and earn salaries and commission. Independent floor brokers are brokers who independently handle orders for other broker-dealers and financial institutions.

#### THE NYSE SPECIALIST

All trading of securities on the NYSE is conducted through an auction process. The auction process for each security is managed by the exclusive specialist for that security. The specialist is a broker-dealer who applies for and, if accepted, is assigned the role to maintain a fair and orderly market in its specialist stocks. The number of specialist units on the NYSE has decreased from 37 at December 31, 1996 to nine at December 31, 2001. A recently announced transaction, if consummated, would further reduce the number of specialist units on the NYSE to eight. Of the nine specialist units, the three largest specialist units as ranked by their number of specialist stocks were responsible for approximately 56.0% and 69.6% of the average daily trading volume in 2000 and 2001, respectively.

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A specialist firm is granted a franchise by the NYSE to conduct the auction in each of its NYSE-listed stocks. Specialist firms conduct their auctions at specific trading posts located on the floor of the NYSE. Because the specialist firm runs the auction in its specialist stocks, it knows of all bids and offers in those stocks and gathers orders to price its stocks appropriately.

Specialist firms compete for the original listing of stocks through an allocation process organized by the NYSE. As part of this allocation process, companies seeking a listing may select a specialist firm in one of two ways. Under the first method, the NYSE's allocation committee selects the specialist firm based on specific criteria. Under the second method, available since March 1997, the listing company requests that the allocation committee select three to five potential specialist firms suitable for the stock, based on criteria specified by the listing company. The listing company then has the opportunity to meet with each specialist firm identified by the allocation committee. Within one week after meeting the competing specialist firms, the listing company must select a specialist firm. Currently, substantially all of the companies seeking a listing on the NYSE are opting to make the final choice of their own specialist firm under the second allocation method.

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When assigned a particular stock, the specialist firm agrees to specific obligations. The specialist firm's role is to maintain, as far as practicable, trading in the stock that will be fair and orderly. This implies that the trading will have reasonable depth and price continuity, so that, under normal circumstances, a customer may buy or sell stock in a manner consistent with market conditions. A specialist firm helps market participants achieve price improvement in their trades because the best bids and offers are discovered through the auction process. In performing its obligations, the specialist firm is exposed to all transactions that occur in each of its specialist stocks on the NYSE floor. In any given transaction, the specialist firm may act as:

- o an auctioneer by setting opening prices for its specialist stocks and by matching the highest bids with the lowest offers, permitting buyers and sellers to trade directly;
- o a facilitator bringing together buyers and sellers who do not know of each other in order to execute a trade which would not otherwise occur;
- o an agent for broker-dealers who wish to execute transactions as instructed by their customers (typically, these orders are limit orders entrusted to the specialist at prices above or below the current market price); or
- o a principal using its own capital to buy or sell stocks for its own account.

The specialist firm's decision to buy or sell shares of its specialist stocks as principal for its own account may be based on obligation or inclination. For example, the specialist firm may be obligated to buy or sell its specialist stock to counter short-term imbalances in the prevailing market, thus helping to maintain a fair and orderly market in that stock. At other times, the specialist firm may be inclined to buy or sell the stock as principal based on attractive opportunities. The specialist firm may trade at its election so long as the trade will contribute to a fair and orderly market. In actively-traded stocks, the specialist firm continually buys and sells its specialist stocks at varying prices throughout each trading day. The specialist

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firm's goal and expectation is to profit from differences between the prices at which it buys and sells these stocks. In fulfilling its specialist obligations, however, the specialist firm may, at times, be obligated to trade against the market, adversely impacting the profitability of the trade. In addition, the specialist firm's trading practices are subject to a number of restrictions, as described in "Operations--NYSE Rules Governing Our Specialist Activities."

### RECENT TRENDS IN NYSE TRADING AND THE SPECIALIST'S ROLE

Specialist firms generate revenues by executing trades, either as agent or principal, in their specialist stocks. Accordingly, the specialist firms' revenues are significantly impacted by the volume of trading on the NYSE. This volume has increased significantly in recent years. The increase in trading volume has resulted from a number of factors, including:

- o an increase in the number of households investing in stocks;
- o an increase in the amount of assets managed through retirement plans, mutual funds, annuity and insurance products, index funds and other institutional investment vehicles;

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- o the increased popularity and use of computerized trading, hedging and other derivative strategies;
- o an increase in NYSE-listed stocks due to:
  - o transfers from Nasdaq;
  - o an increase in listings of foreign companies; and
  - o initial public offerings and spin-offs;
- o higher equity portfolio turnover by individuals and institutional investors as a result of lower commission rates and other transaction costs;
- o trading in decimal price increments;
- o an increase in the amount of shares traded due to stock splits and stock dividends; and
- o on-line trading.

These factors have, in turn, been influenced by low interest rates and low levels of inflation.

In January 2001, the NYSE commenced trading in decimals. Although the NYSE average daily trading volume for 2001 increased over prior years, the full effects of decimalization on the marketplace and specialist profitability are still uncertain. The NYSE also has increased the window for providing commission-free execution of trades to five minutes from two minutes. The NYSE is also considering the following additional changes:

- o longer trading days; and
- o trading of foreign stocks in ordinary form side by side with their American Depository Receipts .

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These additional changes, if instituted, will likely contribute to additional growth in NYSE trading volume.

The majority of trades in NYSE-listed stocks take place through NYSE specialist firms. In 2001, specialist firms handled approximately 83.6% of trades in NYSE-listed stocks. Trades in NYSE-listed stocks also are generally effected as follows:

- o some stocks are listed on multiple exchanges, such as regional exchanges, and trades take place on those exchanges;
- o NYSE members may trade NYSE-listed stocks off the NYSE in the over-the-counter market; and

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- o non-NYSE members may trade NYSE-listed stocks off the NYSE in over-the-counter markets.

Technological advances have contributed to the increased trading through alternative trading systems, called ATSS, such as electronic communications networks, or ECNs, and crossing systems. While the first ECN was created in 1969, most of the others currently in operation were started in the past few years. These systems electronically facilitate the matching of buy and sell orders that are entered by their network members. If a match does not occur, some ATSS will forward unfilled orders to other ATSS or to exchanges such as the NYSE. Some of these networks also allow limited negotiation between members to facilitate a match. These ATSS generally limit trades over their systems to their members, who are typically large financial institutions, well-capitalized traders or brokerage firms. Additionally, some ATSS are being developed to facilitate trading by retail investors. In April 1999, the SEC ruled that these networks are allowed, and in specified cases are required, to register and become subject to regulation as stock exchanges.

The percentage of annual trading of NYSE listed stocks on the NYSE has ranged from 82.5% to 83.7% for the past five years. It is unclear, however, how the alternative trading methods and new technologies just described or that may be developed will affect the percentage of trading in listed stocks conducted on the NYSE. The NYSE has indicated that it is studying the possibility of embracing electronic communications network technology to expand trading. ATSS may be developed, organized and operated by large brokerage houses and investment banks with substantial capital, better access to technology and direct access to investors. As a result, these parties may be well positioned to direct trading to ATSS. These alternative trading methods may account for a growing percentage of the trading volume of NYSE-listed stocks.

The accelerating growth of trading volume, the increase in stock prices on the NYSE in the 1990s and the more recent increased volatility of stock prices have increased the demands upon specialists. In order to fulfill their obligations, specialists are required to execute a greater number of trades in shorter periods of time with greater price volatility. In addition, specialists are called upon to take larger positions in their stocks. These factors have led to a consolidation of specialist units in the past five years. The NYSE specialist market has become dominated by a number of large, well-capitalized firms that are able to provide an enhanced level of service.

### LABRANCHE'S COMPETITIVE POSITION

We are committed to providing the highest quality service to our various constituencies. We believe our success is based on the following factors:

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- LEADING POSITION IN THE SPECIALIST MARKET. We have a long-standing reputation as one of the leading specialist firms on the NYSE. We have successfully grown our business and improved our services through widely varying market conditions. Trading in the stocks for which we acted as specialist during 2001 accounted for 27.6% of the dollar volume on the NYSE and 28.5% of the share volume. Based on these percentages, we were the largest specialist firm on the NYSE. We are continuing to develop our relationships with ATSS and to embrace new technologies in trading platforms.

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- DIVERSE AND HIGH QUALITY SPECIALIST STOCKS. Our listed companies operate in a variety of industries including financial services, media, oil and gas, retail, technology and telecommunications. Many of our listed companies are leaders in their respective fields. Acting as specialist in the stocks of industry leaders should benefit us as these leading companies continue to expand their businesses through internal growth and acquisitions.
- STRONG MARKET-MAKING SKILLS. We utilize our strong market-making skills to actively trade as principal in our specialist stocks. In our opinion, we significantly improve liquidity in our specialist stocks, particularly during periods of market volatility. In 2001, approximately 33.4% of our trades were as principal as compared to an average of approximately 30.6% for all NYSE specialists.
- INNOVATIVE CUSTOMER-ORIENTED SERVICES. We are committed to providing our listed companies with a high level of service, in addition to our specialist functions on the trading floor. We provide our listed companies with detailed reports on the trading activity of their stocks. We also maintain frequent contact with our listed companies to discuss the trading in their stock. In addition, we were the first specialist firm to:
  - host an annual listed company conference;
  - publish a company newsletter; and
  - commission customer satisfaction surveys from our listed companies.
- COMPLETED ACQUISITIONS. Since 1997, we have acquired the following ten specialist operations, solidifying our position as one of the leading NYSE specialist firms, as well as establishing and expanding our presence on the AMEX:
  - a portion of the specialist operations of Stern Bros., LLC (July 1997);
  - Ernst, Homans, Ware & Keelips (August 1997);
  - Fowler, Rosenau & Geary, LLC (July 1998);
  - Henderson Brothers, Inc. (March 2000);
  - Webco Securities, Inc. (March 2000);
  - the assets and operations of an AMEX options specialist unit

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that acted as the specialist in the options of 21 common stocks (December 2000);

- o ROBB PECK McCOOEY Financial Services, Inc. (March 2001);
- o the assets and operations of an AMEX specialist firm, Cranmer & Cranmer, Inc. (August 2001);

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- o the remaining interest that we did not previously own in the specialist business conducted as a joint account by us, R. Adrian & Company, LLC and Freedom Specialist Inc. (September 2001); and
- o Bocklet & Company, LLC (October 2001).
- o OTHER ACQUISITIONS. In March 2001, we also acquired ITTI , a company providing front-end order execution, analysis and reporting solutions for the wholesale securities dealer market.

Our objective is to continue the growth in our revenues and profits by continuing to be aggressive in positioning ourselves in the NYSE allocation process. Between March 1997, when the NYSE adopted the new allocation procedure, and December 31, 2001, we participated in 178 allocation pools for listed companies and were selected in 87 of them by management of the listed companies.

### ACQUISITIONS DURING 2001

#### INTERNET TRADING TECHNOLOGIES, INC.

On March 13, 2001, we acquired all the outstanding capital stock of ITTI, a company that provides front-end order execution, analysis and reporting solutions for the wholesale securities dealer market. We operated ITTI as a separate subsidiary until December 31, 2001, when it was merged with and into our RPM Clearing Corporation subsidiary.

#### ROBB PECK MCCOOEY FINANCIAL SERVICES, INC.

On March 15, 2001, we acquired ROBB PECK McCOOEY Financial Services, Inc. ("RPM") for approximately 6.9 million shares of our common stock and 100,000 shares of our Series A preferred stock. Each share of our Series A preferred stock delivered to the former RPM stockholders entitles the holder thereof to cumulative preferred cash dividends at an annual rate of 8% for the first four years, 10% for the fifth year and 10.8% thereafter, certain voting rights and preferred distributions upon liquidation. Approximately 54,500 shares of our Series A preferred stock issued to the RPM stockholders are currently held in escrow in order to secure the RPM stockholders' indemnification obligations to us. In connection with our acquisition of RPM, each formerly outstanding RPM option was converted into an immediately exercisable option to purchase 98.778 shares of our common stock. We also assumed RPM's liabilities and obligations under the RPM Deferred Compensation Plan which provides for the payment on or before December 15, 2007 of approximately \$30.2 million, plus interest at 8% per year, to the former RPM option holders. We also assumed RPM's liabilities and obligations under RPM's retention bonus pool, which requires the payment of \$9.0 million as bonus compensation on March 15, 2004 to as many as 31 former employees of RPM, subject to certain service requirements.

In connection with the RPM acquisition, we:

- o acquired an additional 27 NYSE memberships, of which 10 were owned by RPM, pursuant to A-B-C agreements, 15 were leased from third parties and two seats were owned by RPM employees and contributed to RPM for its use;
- o hired an additional 215 employees, including 120 employees in RPM's clearing operations and 95 employees in RPM's specialist operations, of which 27 are specialists and 68 are trading assistants. In addition, nine former RPM employees became managing directors; and
- o acquired an additional 42,300 square feet of office space.

CRANMER & CRANMER, INC.

On August 13, 2001, LaBranche & Co. LLC acquired all the assets relating to the AMEX stocks and options specialist operations of Cranmer & Cranmer, Inc. ("Cranmer") for an aggregate of approximately \$9.2 million, 100,000 shares of our common stock and an amount equal to the equity capital of Cranmer, including the net value of Cranmer's open security positions on the closing date of the acquisition.

FREEDOM SPECIALIST INC, R. ADRIAN & COMPANY, LLC AND LABRANCHE & CO. LLC JOINT BOOK

On September 20, 2001, LaBranche & Co. LLC acquired the interests in the Freedom Specialist Inc. ("Freedom"), R. Adrian & Company, LLC ("Adrian") and LaBranche & Co. LLC Joint Book (the "Joint Book") which it did not previously own for an aggregate of approximately \$13.6 million in cash, 54,750 shares of our common stock and an amount equal to Freedom's and Adrian's respective shares of the equity capital of the Joint Book on the closing date of the acquisition. Simultaneously with this acquisition we transferred the specialist operations of the Joint Book to our subsidiary LaBranche & Co. LLC.

BOCKLET & COMPANY, LLC

On October 18, 2001, LaBranche & Co. LLC acquired Bocklet & Company, LLC ("Bocklet") for an aggregate of \$20.0 million in cash, of which \$5.0 million was paid at the closing, \$5.0 million was paid on January 18, 2002 and \$5.0 million is payable on each of April 18, 2002 and July 18, 2002 and 1,100,000 shares of our common stock. In addition, an amount equal to the equity capital of Bocklet on the closing date of the acquisition will be paid in three equal installments of which approximately \$1.4 million was paid January 18, 2002 and the remaining amount will be paid six and nine months from the closing date.

SPECIALIST COMPANIES

As of December 31, 2001, we acted as specialist for 591 common stocks listed on the NYSE. Our listed companies operate in a variety of industries including financial services, media, oil and gas, retail, technology and telecommunications. They range in market capitalization from some of the smallest on the NYSE to some of its largest and well-known corporations. Of our NYSE common stock listings, 123 and 69 were foreign listings as of December 31, 2001 and

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December 31, 2000, respectively. As of February 28, 2002, we represented 126 foreign listings on the NYSE. The following is a list of our top 50 listed companies in terms of market capitalization as of February 28, 2002 in order of their respective global market capitalization (read in descending order from top to bottom, left to right):

|  |                                      |
|--|--------------------------------------|
| Exxon Mobil Corporation                    | Wachovia Corporation                 |
| GlaxoSmithKline plc                        | Federal Home Loan Mortgage Corp.     |
| Merck & Co., Inc.                          | U.S. Bancorp                         |
| SBC Communications Inc.                    | Diageo plc                           |
| Philip Morris Companies Inc.               | Banco Bilbao Vizcaya Argentaria S.A. |
| HSBC Holdings plc                          | Lowes Companies, Inc.                |
| TOTAL Fina Elf S.A.                        | Enel S.p.A.                          |
| Nokia Corporation                          | Schlumberger Limited                 |
| Novartis AG                                | PetroChina Company Ltd               |
| Toyota Motor Corporation                   | Koninklijke Philips Electronics N.V. |
| Bristol-Meyers Squibb Company              | First Data Corp.                     |
| Wells Fargo & Company                      | The News Corporation Limited         |
| Kraft Foods Inc.                           | National Australia Bank Limited      |
| United Parcel Service, Inc.                | Ford Motor Corp.                     |
| Tyco International Ltd.                    | Clear Channel Communications, Inc.   |
| AT&T Corp.                                 | ABN Amro Holding N.V.                |
| Taiwan Semiconductor Manufacturing Company | Emerson Electric Co.                 |
| Medtronic, Inc.                            | Household International, Inc.        |
| Morgan Stanley Dean Witter & Co.           | United Microelectronics Corporation  |
| Nippon Telegraph and Telephone Corporation | AT&T Wireless Group, Inc.            |
| Schering-Plough Corp.                      | Lucent Technologies Inc.             |
| American Express Company                   | Fox Entertainment Group, Inc.        |
| Du Pont (E.I.) de Nemours and Company      | SunTrust Banks, Inc.                 |
| ING Groep N.V.                             | The Kroger Co.                       |
| Minnesota Mining & Manufacturing Company   | Compaq Computer Corporation          |

### OPERATIONS

#### NYSE RULES GOVERNING OUR SPECIALIST ACTIVITIES

Under NYSE rules, a specialist has a duty to maintain, as far as practicable, a fair and orderly market in its specialist stocks. In order to fulfill its obligations, the specialist must at times trade for its own account, even when it may adversely affect the specialist's profitability. In addition, under some circumstances, the specialist is prohibited from making trades as principal in its specialist stocks. The specialist's obligations are briefly described below.

**REQUIREMENT TO TRADE AS PRINCIPAL.** A specialist must buy and sell securities as principal when necessary to minimize an actual or reasonably anticipated short-term imbalance between supply and demand in the auction market. The specialist must effect these transactions when their absence could result in an unreasonable lack of continuity and/or depth in their specialist stocks. The specialist is not expected to act as a barrier in a rising market or a support in a falling market,

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but must use its own judgment to try to keep such price increases and declines equitable and consistent with market conditions.

A specialist must make firm and continuous two-sided quotations that are timely and that accurately reflect market conditions. In making these quotations, the specialist's transactions are calculated to contribute to the

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maintenance of price continuity with reasonable depth. Following is an illustration of how a specialist acts as principal to maintain price continuity:

The most recent sale in a listed stock was \$50, the best public bid (to buy) on the specialist's book is \$49.75, and the best public offer (to sell) on the book is \$50.25. A broker who wants to buy 100 shares at the market in this instance without a specialist would purchase at \$50.25, the offer price. Similarly, a broker seeking to sell 100 shares without a specialist would receive \$49.75, the bid price. The specialist, who is expected to provide reasonable price continuity, in this case might narrow the quote spread by offering or bidding for stock for its own account. In this instance, the broker who wants to buy 100 shares might buy at \$50.0625 from the specialist, as opposed to buying the same amount of shares from the best offer of \$50.25, thereby offering price improvement to the customer. In the next trade, a broker willing to sell 100 shares might sell to the specialist at \$50, as opposed to selling to the best available bid of \$49.75, again achieving price improvement for the customer.

TRADING RESTRICTIONS. In trading for its own account, the specialist must avoid initiating a market-destabilizing transaction. All purchases and sales must be reasonably necessary to permit the specialist to maintain, as far as practicable, a fair and orderly market in its specialist stocks. In addition, the specialist must comply with the following trading requirements:

- o A specialist must first satisfy a customer's market buy order (an order to buy at the prevailing market price) before buying any stock for its own account. Similarly, a specialist must first satisfy a customer's market sell order (an order to sell at the prevailing market price) before selling any stock for its own account.
- o A specialist must first satisfy a customer's limit order held by it before buying or selling at the same price for its own account. A limit order is an order either to buy only at or below a specified price, or to sell only at or above a specified price. A specialist may not have priority over any customer's limit order. A specialist, however, may buy or sell at the same price as a customer limit order as long as that limit order is executed first.
- o If a public buyer wants to buy at a particular price and a seller wants to sell at the same price, the buyer and seller trade directly with each other, and the specialist should not interfere in the transaction.
- o The specialist does not charge commissions for trades in which it acts as a principal.
- o Except in some circumstances in less active markets, the specialist may not, without permission from an NYSE official, initiate destabilizing trades for its own account which cause the stock price to rise or fall.

- o Any transactions by the specialist for its own account must be effected in a reasonable and orderly manner in relation to the condition of the general market, the market in the particular stock and the adequacy of the specialist's position to the immediate and reasonably anticipated needs of the market.

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In addition, the specialist cannot be in a control relationship with any of its listed companies. This means a specialist may not acquire more than 5% of any common or preferred issue of its specialist stocks and may not own 10% or more of any common or preferred stock. A specialist may not hold any position as an officer or director or receive payments or loans or engage in business transactions with any of its listed companies.

### RISK MANAGEMENT

Because our specialist activities expose our capital to significant risks, managing these risks is a constant priority for us. Our central role in the auction process helps us to reduce risks by enabling us to incorporate up-to-date market information in the management of our inventory, subject to our specialist obligations. In addition, we have developed a risk management process, which is designed to balance our ability to profit from our specialist activities with our exposure to potential losses. Our risk management process includes participation by our executive operating committee, our floor management committee, our floor team captains and our specialists. These parties' roles are described as follows:

**EXECUTIVE OPERATING COMMITTEE.** Our executive operating committee is composed of Michael LaBranche, Anthony M. Corso, Alfred O. Hayward, Jr., Robert M. Murphy and James G. Gallagher. This committee is responsible for approving all risk management policies and trading guidelines for particular specialist stocks, after receiving input and proposals by the floor management committee. In addition, our executive operating committee reviews all unusual situations reported to it by our floor management committee.

**FLOOR MANAGEMENT COMMITTEE.** Our floor management committee is composed of Anthony M. Corso, Alfred O. Hayward, Jr., Robert M. Murphy, John McGraner, Michael Nichols, Thomas G. McLaughlin and Eugene McCarthy. This committee is responsible for formulating and overseeing our overall risk management policies and risk guidelines for each of our specialist stocks. In arriving at these policies and guidelines, our floor management committee considers the advice and input of our floor team captains. Our floor management committee meets with all floor team captains no less than once a month to review and, if necessary, revise the risk management policies for our firm as a whole and/or for particular specialist stocks. In addition, a member of our floor management committee is always available on the trading floor to review and assist with any unusual situations reported by a captain. Our floor management committee reports to our executive operating committee about each of these situations.

**FLOOR TEAM CAPTAINS.** We have 21 floor team captains who monitor the activities of our specialists throughout the trading day from various positions at our trading posts. The captains observe trades and constantly review trading positions on a real-time basis through our information systems. In addition, the captains are readily available to assist our specialists in determining when to deviate from our policies and guidelines to react to any unusual situations or

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market conditions. The captains must report these unusual situations to management, including any deviations from our policies and guidelines. Captains meet with each specialist at least once a week to evaluate the specialist's adherence to our risk management policies and guidelines. Captains also meet among themselves at least twice weekly to review risk policies and guidelines and, if appropriate, make new recommendations to the floor management committee.

**SPECIALISTS.** Our specialists conduct auctions based upon the conditions of the marketplace. In doing so, specialists observe our risk management policies

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and guidelines as much as practicable. Specialists must immediately notify a captain of any unusual situations or market conditions requiring a deviation from our policies and guidelines.

We rely heavily on our information systems in conducting our risk management. Management members and captains must constantly monitor our positions and transactions in order to mitigate our risks and identify troublesome trends as they occur. We have invested substantial capital, along with the NYSE, in real-time, on-line systems which give management instant access to specific trading information at any time during the trading day, including:

- o our aggregate long and short positions;
- o the various positions of each of our trading professionals;
- o our overall position in a particular stock;
- o capital and profit-and-loss information on an aggregate, per specialist or per issue basis; and
- o average position size.

CIRCUIT BREAKER RULES. The NYSE has instituted certain circuit breaker rules intended to halt trading in all NYSE-listed stocks in the event of a severe market decline. The circuit breaker rules impose temporary halts in trading when the Dow Jones Industrial Average drops a certain number of points. Effective January 2, 2001, circuit breaker levels are set quarterly at 10, 20 and 30 percent of the Dow Jones Industrial Average closing values of the previous month, rounded to the nearest 50 points.

### LISTED COMPANY SERVICES

We are committed to providing our listed companies with a high level of service, in addition to our specialist functions on the trading floor. We have a Corporate Relations Department consisting of 19 full-time employees devoted to serving our listed companies. The most important function of the Corporate Relations Department is to provide current information to the listed companies. Upon request, our Corporate Relations Department provides our listed companies with the following reports:

- o daily reports on the trading results of their stock;
- o real-time data regarding intra-day trading activity in their stock; and

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- o weekly, monthly and yearly reports which analyze short and long term trading trends in their stock.

In addition to providing trading information, we help to educate our listed companies on general market trends. We organize annual educational conferences that review trends in the securities industry and NYSE trading. We also publish for and distribute to our listed companies a periodic newsletter that reviews market trends. Finally, we survey our specialist companies annually on the quality of our services, and use the information obtained in these surveys to continually improve our services.

### NYSE MEMBERSHIPS

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NYSE memberships are granted only to individuals, and each individual specialist must own or lease a NYSE membership. As of December 31, 2001, 118 NYSE memberships were used or available for use in our business. As of February 28, 2002, our 112 specialists owned or leased NYSE memberships under the following arrangements:

- o 10 memberships were owned directly by 10 of our employees, and we paid these employees at prevailing market rates for the use of their memberships;
- o 34 were owned by specialists, who acquired their memberships through financing provided by us pursuant to A-B-C agreements; and
- o 68 were leased by specialists from other individual members, and we pay and guarantee the lease payments.

Additionally, LaBranche & Co. LLC has financed the acquisition of two additional NYSE memberships that are available for use by its employees. Our LFSI subsidiary also has financed the acquisition of two NYSE memberships that are available for use by its employees. Two additional memberships are directly owned and used by two LFSI employees, and LFSI pays these employees at prevailing market rates for the use of their memberships.

### AMEX OPTIONS SPECIALIST UNIT

In December 2000, we purchased the assets and operations of an AMEX options specialist unit and, in August 2001, we expanded our AMEX specialist activities by purchasing the assets and operations of Cranmer, another AMEX specialist firm. Our AMEX specialist business is conducted by our LaBranche & Co. LLC subsidiary. As of December 31, 2001 this unit acted as the specialist in 57 stocks and 122 options on the AMEX. As of February 28, 2002 this unit acted as specialist in 56 stocks and 125 options on the AMEX. In our view, these acquisitions enhance our commitment to the listed auction market and are important steps in the implementation of our growth strategy. As of December 31, 2001, eight of the nine AMEX memberships utilized by our AMEX specialist unit were leased by eight specialist employees of that unit, and one membership was owned directly by an employee. LaBranche & Co. LLC pays and guarantees the rental payments due under the leases of AMEX memberships and pays its employee for the use of his AMEX membership.

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### OUR INFORMATION AND COMMUNICATIONS SYSTEMS AND THE NYSE'S SUPER-DOT SYSTEM

As a self-clearing broker-dealer, we have made significant investments in our trade processing systems. Our use of and dependence on technology have allowed us to maintain our significant growth over the past several years. In addition to using consultants who primarily service the specialist industry, we have an in-house information technology staff. As of February 28, 2002, we cleared an average of approximately 126,000 principal trades per day. We also conduct clearing operations involving trades for third parties through our LFSI subsidiary.

Our information systems send and receive data from the NYSE through a dedicated data feed. Our systems enable us to monitor, on a real-time basis, our profits and losses along with our trading positions. The NYSE supplies us with specialist position reporting system terminals both on the trading floor and in our offices. These terminals allow us to monitor our trading profits and losses as well as our positions.

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We have a back-up disaster recovery center in New Jersey. The back-up system operates as a mirror image of our primary computer system in New York City through a direct connection between the two sites which we utilize to back-up all data on an hourly basis. We also test both systems on a regular basis to assure that they are fully operational. Subsequent to the September 11 disaster, our operations group utilized our New Jersey site to clear our specialist business, as our primary facilities were inaccessible. Due to the effectiveness of our back-up facility, our operations were not materially impacted. We are reevaluating our business continuity processes and are formalizing a comprehensive plan. We also are in the process of securing a second back-up facility in another New York state location so that all aspects of our operations are safeguarded from potential business interruption.

In executing trades on the NYSE, we receive electronic orders from the Super-Dot system, an order routing system operated by the NYSE. The Super-Dot System is designed to handle individual orders of up to 100,000 shares and is essentially an electronic broker. Orders that originate through the Super-Dot system are routed directly to us through our computer system at the NYSE. When we receive an order from the Super-Dot system, we conduct the same auction process and we are subject to the same obligations as with any other order.

Our information technology staff has developed software which enables our corporate relations staff and our specialists to share information with each other regarding upcoming company and industry conferences. In addition, we monitor each of our specialist stocks intra-day to see if there are any significant price and/or volume variances of which we should alert the listed company. This has proven to be a valuable customer service tool.

### CLEARING OPERATIONS

Our LFSI clearing subsidiary provides services to individual and institutional clients, including traders, professional investors, institutions and broker-dealers. These services include clearing and custody services, customer account maintenance and customized data processing services. The use of new technologies at our LFSI subsidiary has enhanced its ability to handle an increasing volume of transactions. These technologies allow our LFSI subsidiary to provide customized and detailed account information and implement straight-through processing

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solutions to better serve customers. Before conducting business with a prospective customer, we review such factors as the prospective customer's experience in the securities industry, financial condition and personal background.

Our LaBranche & Co. LLC subsidiary acts as a self-clearing broker-dealer for our NYSE and AMEX equity specialist business. All trades made in connection with our NYSE and AMEX equity specialist business are cleared by LaBranche & Co. LLC.

### DIRECT ACCESS BUSINESS

The Institutional Client Group division of our LFSI subsidiary places its customers in direct contact with the NYSE. Utilizing easy-to-use web-based technology, this division provides its institutional customers with the choice of two conduits for sending their order flow directly to the point of sale on the floor of the NYSE. Orders that require special attention can be sent to one of this division's licensed floor brokers for customized handling. Otherwise,

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customers can send their orders directly to the specialist's order book using the NYSE's Super-Dot system. The Institutional Client Group division's brokers take advantage of the NYSE's advanced wireless technology to communicate directly with its trading customers. By employing the advanced technology, its customers receive extremely fast trade executions and confirmations. All customer orders are treated with strict confidentiality and anonymity, allowing for the best execution with the least market impact. In addition, the Institutional Client Group division's customers are given all the benefits of straight-through, seamless trade processing. Our LFSI subsidiary also clears and delivers the trades directly to its customers' depository accounts.

### PROPRIETARY TRADING

In 1995, we initiated a proprietary trading program, seeking to leverage our trading and market experience. Our strategy is short-term oriented, and most of our positions are maintained intra-day and not held overnight. During 2001 our five traders focused primarily on stocks listed on the NYSE. In 2001, we derived 0.3% of our revenues from our proprietary trading. Our proprietary trading desk utilizes a Windows NT based trade reporting system which captures all trades executed by the trading desk and marks all positions to market. Proprietary traders who are employees of LaBranche & Co. LLC are not permitted to trade in stocks for which we act as specialist. As of January 1, 2002, three of our proprietary traders became employees of our LFSI subsidiary, and are now permitted to trade stocks for which we act as specialist.

### MARKETING

It is a priority for our management to proactively identify potential listing companies before the allocation process begins. We contact these companies and commence our marketing efforts upon determining that they are considering listing on the NYSE. Our marketing efforts typically consist of members of our management group visiting with the companies that are considering listing on the NYSE and describing our services. We also provide written literature describing our operations, our listed companies, our more than 75-year history as a specialist firm and a general overview of the specialist industry.

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### REGULATORY MATTERS

#### GENERAL

The securities industry in the United States, including all broker-dealers, is subject to regulation under both federal and state laws. In addition, the SEC and the NYSE require compliance with their rules and regulations. As a matter of public policy, regulatory bodies are charged with safeguarding the integrity of the securities and other financial markets and with protecting the interests of investors participating in those markets.

As a broker-dealer, we are subject to regulations concerning operational and financial aspects of our business. We are subject to registration requirements with various government entities and self-regulatory organizations, commonly referred to as SROs, with which we must comply before we can conduct our business. We are also subject to laws, rules and regulations forcing us to comply with financial reporting requirements, trade practices, capital structure requirements, and record retention requirements governing the conduct of our directors, officers and employees. Failure to comply with any of these laws, rules or regulations could result in censure, fine, the issuance of cease-and-desist orders or the suspension or disqualification of our directors,

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officers or employees, and other negative consequences, which could have an adverse effect on our business.

As a NYSE specialist firm, we are under constant review by the NYSE on all aspects of our operations and financial condition. As part of the price discovery mechanism implemented by the NYSE, every specialist transaction is published immediately on the tape and is broadcast worldwide. The NYSE also employs sophisticated monitoring and stringent rules approved by the SEC. The NYSE's Market Surveillance Division examines specialists' trading in all stocks, every trading day, including specialists' decisions to trade or to not trade as principal.

### CAPITAL REQUIREMENTS

As a broker-dealer, we are subject to SEC Rule 15c3-1, which requires minimum net regulatory capital. We are required to maintain minimum net capital, as defined, equivalent to the greater of \$100,000 or 1/15 of our aggregate indebtedness, as defined. At December 31, 2001, our net capital, as defined by this rule, was \$484.2 million and exceeded minimum requirements by \$481.4 million.

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. Under changes to Rule 104, effective October 30, 2000 specialist units that exceed five percent in any of the NYSE's four concentration measures must maintain minimum net liquid assets based upon the securities for which they act as the specialist. The requirements state that the net liquid assets must be equivalent to \$4.0 million for each stock in the Dow Jones Industrial Average, \$2.0 million for each stock in the S&P 100 Stock Price Index, excluding stocks included in the previous classification, \$1.0 million for each stock in the S&P 500 Stock Price Index, excluding stock included in the previous classifications, \$500,000 for each common stock, excluding bond funds and stocks included in the previous classifications, and \$100,000 for each stock not included in any of the above classifications. In addition, the NYSE requires any

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new specialist entities that result from a merger, acquisition, consolidation or other combination of specialist entities to maintain net liquid assets equivalent to the greater of either: (1) the aggregate net liquid assets of the specialist entities prior to their combination or (2) the new capital requirements prescribed under Rule 104. As of December 31, 2001, LaBranche & Co. LLC's net liquid asset requirement was \$446.0 million, and its actual net liquid assets were approximately \$491.5 million. Net liquid assets for a specialist who also engages in transactions other than specialist activities is based upon its excess net capital as determined in accordance with SEC Rule 15c3-1.

As registered broker-dealers and member firms of the NYSE, our former subsidiary Henderson Brothers and our RPM Clearing Corporation subsidiary were also subject to SEC Rule 15c3-1 as adopted and administered by the NYSE and the SEC. Under the alternative method permitted by this rule, the minimum required net capital for each of these subsidiaries as of December 31, 2001 was equal to the greater of \$250,000 or 2% of aggregate debit items as defined. As of December 31, 2001, the combined net capital of these subsidiaries as defined under SEC Rule 15c3-1 was \$20.5 million which exceeded minimum requirements by \$19.7 million.

Failure to maintain the required net capital and net liquid assets may subject us to suspension or revocation of SEC registration or suspension or

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expulsion by the NYSE.

### NEW PROPOSED REGULATORY LEGISLATION

On October 26, 2001, President Bush signed the USA PATRIOT Act, aimed at giving the government new powers in the war on terrorism. Title III of the new legislation, the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, imposes significant new anti-money laundering requirements on all financial institutions, including domestic banks and domestic operations of foreign banks, broker-dealers, futures commission merchants and investment companies. We do not currently know the full effects of this legislation, but it will result in additional reporting and disclosure requirements.

### COMPETITION

We obtain each of our new listings on the NYSE by participating in an allocation process. As part of this process, either the allocation committee of the NYSE or the listing company chooses the specialist firm. We compete with other specialist firms based on a number of factors, including:

- o the strength of our capital base;
- o our willingness to commit our own capital and trade for our own account while conducting our specialist operations; and
- o the ancillary services we offer our specialist companies, such as providing information on the trading activities in their stocks.

The following are the remaining specialist units as of February 28, 2002, listed in descending order based on number of common stock listings:

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- o LaBranche & Co. LLC
- o Spear, Leeds & Kellogg Specialist
- o Fleet Meehan Specialists, Inc.
- o Wagner Stott Bear Specialists, LLC
- o Van Der Moolen Specialists USA
- o Performance Specialist Group, LLC
- o Susquehanna Specialists, Inc.
- o Walter N. Frank & Co. LLC

The competition for obtaining new listed companies is intense. We expect competition to continue and intensify in the future. Some of our competitors may have greater financial resources than we have and may also have greater name recognition. These competitors may be able to respond more quickly to new or evolving opportunities and listed company requirements. They may also be able to undertake more extensive promotional activities to attract new listing companies.

### EMPLOYEES

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As of December 31, 2001, we had 545 full-time employees, including 53 managing directors. As of February 28, 2002, we had 550 full time employees, including 63 managing directors with:

- o 123 specialists, including 55 managing directors and 11 AMEX options specialists;
- o 245 trading assistants;
- o 19 corporate relations department employees;
- o 52 clearing operations employees;
- o 22 individuals employed as proprietary traders, floor brokers and registered representatives; and
- o 89 management, administration and finance staff, including 8 managing directors.

Our employees are not covered by a collective bargaining agreement. We have never experienced an employment-related work stoppage. We consider our employee relations to be good.

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### ITEM 2. PROPERTIES.

Our offices are located at One Exchange Plaza, New York, New York, where we lease approximately 45,000 square feet under three separate leases, with 9,000 square feet expiring in January 2003 and approximately 36,000 square feet expiring in January 2008. We also lease approximately 45,000 square feet at 120 Broadway, New York, New York, under a lease expiring in March 2006. In addition, we lease four trading posts on the floor of the NYSE. We lease approximately 21,000 square feet of additional space at locations in New York and New Jersey under leases expiring between September 2002 and July 2004. We intend to renew the lease that expires in September 2002. We believe that our current leased space is suitable and adequate for the operation of our business as presently conducted and as contemplated to be conducted in the immediate future.

### ITEM 3. LEGAL PROCEEDINGS.

We are not a party to any material legal proceeding.

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

There were no matters submitted to a vote of security holders during the fourth quarter of our fiscal year ended December 31, 2001.

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## PART II

### ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

#### MARKET INFORMATION AND HOLDERS

Our common stock is quoted on the NYSE under the symbol "LAB." The following table sets forth the range of high and low closing sales prices for

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our common stock on the NYSE for the periods indicated:

### FISCAL 2000

-----

|                |       |       |
|----------------|-------|-------|
| First Quarter  | 15.38 | 11.31 |
| Second Quarter | 17.63 | 11.13 |
| Third Quarter  | 36.25 | 15.44 |
| Fourth Quarter | 39.63 | 22.19 |

### FISCAL 2001

|                |       |       |
|----------------|-------|-------|
| First Quarter  | 51.03 | 27.69 |
| Second Quarter | 44.52 | 28.56 |
| Third Quarter  | 30.22 | 19.50 |
| Fourth Quarter | 35.11 | 22.12 |

### FISCAL 2002

|   |       |       |
|---|-------|-------|
| First Quarter<br>(through March 14, 2002) | 36.11 | 29.88 |
|---|-------|-------|

As of March 14, 2002, we had approximately 150 stockholders of record of our common stock and an estimated 4,299 beneficial owners. The closing sale price of our common stock on March 14, 2002 was \$33.30 per share.

### DIVIDEND POLICY

We have never paid cash dividends on our common stock. We do not expect to declare or pay any dividends on our common stock in the foreseeable future, but instead intend to retain all earnings, if any, to invest in our operations. The payment of future dividends is within the discretion of our board of directors and will depend upon our future earnings, if any, our capital requirements, financial condition and other relevant factors.

In connection with our acquisition of RPM, we issued 100,000 shares of our Series A preferred stock. Each outstanding share of our Series A preferred stock entitles the holder thereof

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to cumulative preferred cash dividends at an annual rate of 8% of the liquidation preference per share until the fourth anniversary of the closing of the merger, 10% until the fifth anniversary of the closing, and 10.8% thereafter. Dividends are payable on the first day of January and the first day of July of each year (or if such date is not a regular business day, then the next business day thereafter). Dividends on the issued and outstanding shares of Series A preferred stock are preferred and cumulative and accrue from the date on which they were originally issued. On February 19, 2002, we repurchased approximately 28,164 shares of our Series A preferred stock at \$1,000 per share plus accrued and unpaid dividends through the date of purchase, pursuant to a tender offer commenced on January 18, 2002.

### RECENT ISSUANCE OF UNREGISTERED SECURITIES

In connection with our acquisition of the assets and operations of Cranmer

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on August 13, 2001 we issued 100,000 shares of our common stock to Cranmer in reliance on the exemption from registration contained in Section 4(2) of the Securities Act of 1933. We subsequently registered these shares for resale in November 2001.

In connection with our acquisition on September 20, 2001 of the remaining interest in the Joint Book that we did not already own we issued 54,750 shares of our common stock to Adrian in reliance on the exemption from registration contained in Section 4(2) of the Securities Act of 1933.

In connection with our acquisition of Bocklet on October 18, 2001, we issued 1,100,000 shares of our common stock to the members of Bocklet in reliance on the exemption from registration contained in Section 4(2) of the Securities Act of 1933. We subsequently registered these shares for resale in November 2001.

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### ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA.

The selected consolidated financial data set forth below for the years ended December 31, 2001, 2000 and 1999 and as of December 31, 2001 and 2000 have been derived from our consolidated financial statements, which have been audited by Arthur Andersen LLP, independent public accountants, and are included elsewhere in this filing. The selected consolidated financial data set forth below for the years ended December 31, 1998 and 1997 and as of December 31, 1999, 1998 and 1997 have been derived from our consolidated financial statements, audited by Arthur Andersen LLP, independent public accountants, which are not included elsewhere in this filing. The selected consolidated financial data set forth below should be read in conjunction with the consolidated financial statements and related notes thereto and with "Management's Discussion and Analysis of Financial Condition and Results of Operations," which are included elsewhere in this filing.

|  | YEAR ENDED DE |           |         |
|--|---------------|-----------|---------|
|  | 2001          | 2000      | 1999    |
|  | ----          | ----      | ----    |
| (IN THOUS  |               |           |         |
| STATEMENT OF OPERATIONS DATA:                      |               |           |         |
| REVENUES:  |               |           |         |
| Net gain on principal transactions .....           | \$340,795     | \$282,948 | \$150,9 |
| Commissions .....                                  | 62,866        | 45,381    | 37,2    |
| Other .....  | 20,469        | 16,480    | 12,8    |
|  | -----         | -----     | -----   |
| Total revenues .....                               | 424,130       | 344,809   | 201,0   |
|  | -----         | -----     | -----   |
| EXPENSES:  |               |           |         |
| Employee compensation and benefits .....           | 110,832       | 88,759    | 34,2    |
| Interest .....                                     | 52,049        | 41,893    | 8,2     |
| Depreciation and amortization of intangibles ..... | 39,450        | 18,476    | 5,1     |
| Exchange, clearing and brokerage fees .....        | 22,367        | 5,148     | 3,6     |
| Lease of exchange memberships .....                | 20,536        | 10,933    | 8,4     |
| Legal and professional fees .....                  | 4,959         | 1,868     | 1,6     |
| Communications .....                               | 4,795         | 1,500     | 1,1     |
| Occupancy .....                                    | 3,932         | 1,310     | 9       |
| Other .....  | 8,499         | 8,345     | 3,0     |

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|   | -----     | -----     | -----   |
|---|-----------|-----------|---------|
| Total expenses before managing directors' compensation, limited partners' interest in earnings of subsidiary and provision for income taxes ..... | 267,419   | 178,232   | 66,5    |
| Income before managing directors' compensation, limited partners' interest in earnings of subsidiary and provision for income taxes .....         | 156,711   | 166,577   | 134,4   |
| Managing directors' compensation .....  | --        | --        | 56,1    |
| Income before limited partners' interest in earnings of subsidiary and provision for income taxes .....   | 156,711   | 166,577   | 78,2    |
| Limited partners' interest in earnings of subsidiary .....  | --        | --        | 25,3    |
| Income before provision for income taxes .....  | 156,711   | 166,577   | 52,9    |
| Provision for income taxes .....  | 85,124    | 84,654    | 23,8    |
| Net income .....  | \$ 71,587 | \$ 81,923 | \$ 29,0 |

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|   | AS OF DECEMBER 31, |            |            |         |
|---|--------------------|------------|------------|---------|
|   | 2001               | 2000       | 1999       | 1998    |
|   | ----               | ----       | ----       | ----    |
| BALANCE SHEET DATA:                         |                    |            |            |         |
|   | (IN THOUSANDS)     |            |            |         |
| Cash and short term investments .....       | \$ 189,524         | \$ 287,643 | \$ 109,196 | \$ 25,8 |
| Working capital .....                       | 485,643            | 366,527    | 229,454    | 104,2   |
| Total assets .....                          | 2,000,837          | 1,004,122  | 505,896    | 272,2   |
| Total long-term indebtedness (1) .....      | 429,205            | 397,828    | 162,330    | 48,0    |
| Members' capital/stockholders' equity ..... | 928,358            | 370,901    | 251,972    | 77,0    |

(1) Excludes subordinated liabilities related to contributed exchange memberships.

QUARTERLY RESULTS (UNAUDITED)

The following represents the firm's unaudited quarterly results for 2001 and 2000. These quarterly results were prepared in accordance with accounting principles generally accepted in the United States and reflect all adjustments

(000's omitted, except per share data)

|  | 2001 FISCAL QUARTER |           |           |        |
|--|---------------------|-----------|-----------|--------|
|  | FIRST               | SECOND    | THIRD     | FOUR   |
|  | -----               | -----     | -----     | -----  |
| Total Revenues                           | \$ 97,760           | \$112,762 | \$ 89,121 | \$124, |
| Total Operating Expenses                 | 53,076              | 69,022    | 64,504    | 80,    |
| Income before provision for income taxes | 44,684              | 43,740    | 24,617    | 43,    |

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|                            |         |         |         |       |
|----------------------------|---------|---------|---------|-------|
| Provision for income taxes | 23,760  | 24,523  | 13,379  | 23,   |
|                            | -----   | -----   | -----   | ----- |
| Net Income                 | 20,924  | 19,217  | 11,238  | 20,   |
| Earnings per share         |         |         |         |       |
| Basic                      | \$ 0.41 | \$ 0.30 | \$ 0.16 | \$ 0  |
| Diluted                    | 0.40    | 0.29    | 0.15    | 0     |

(000's omitted, except per share data)

|  | 2000 FISCAL QUARTER |           |           |        |
|--|---------------------|-----------|-----------|--------|
|  | FIRST               | SECOND    | THIRD     | FOUR   |
|  | -----               | -----     | -----     | -----  |
| Total Revenues                           | \$ 78,690           | \$ 87,624 | \$ 81,222 | \$ 97, |
| Total Operating Expenses                 | 38,257              | 46,524    | 42,363    | 51,    |
|  | -----               | -----     | -----     | -----  |
| Income before provision for income taxes | 40,433              | 41,100    | 38,859    | 46,    |
| Provision for income taxes               | 19,878              | 20,975    | 19,911    | 23,    |
|  | -----               | -----     | -----     | -----  |
| Net Income                               | 20,555              | 20,125    | 18,948    | 22,    |
| Earnings per share                       |                     |           |           |        |
| Basic                                    | \$ 0.44             | \$ 0.41   | \$ 0.39   | \$ 0   |
| Diluted                                  | 0.44                | 0.41      | 0.38      | 0      |

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

YOU SHOULD READ THE FOLLOWING DISCUSSION OF OUR FINANCIAL CONDITION AND RESULTS OF OPERATIONS TOGETHER WITH THE FINANCIAL STATEMENTS AND THE NOTES TO SUCH STATEMENTS INCLUDED ELSEWHERE IN THIS FILING. THIS DISCUSSION CONTAINS FORWARD-LOOKING STATEMENTS BASED ON OUR CURRENT EXPECTATIONS, ASSUMPTIONS, ESTIMATES AND PROJECTIONS ABOUT US AND OUR INDUSTRY. THESE FORWARD-LOOKING STATEMENTS INVOLVE RISKS AND UNCERTAINTIES INCLUDING, BUT NOT LIMITED TO THOSE DISCUSSED IN "RISK FACTORS" ATTACHED HERETO AS EXHIBIT 99.1. OUR ACTUAL RESULTS COULD DIFFER

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MATERIALLY FROM THOSE ANTICIPATED IN THESE FORWARD-LOOKING STATEMENTS AS A RESULT OF CERTAIN FACTORS. WE UNDERTAKE NO OBLIGATION TO UPDATE PUBLICLY ANY FORWARD-LOOKING STATEMENTS FOR ANY REASON, EVEN IF NEW INFORMATION BECOMES AVAILABLE OR OTHER EVENTS OCCUR IN THE FUTURE.

#### OVERVIEW

Organized in 1999 in connection with the reorganization of LaBranche & Co. from partnership to corporate form and the related initial public offering of our common stock, LaBranche & Co Inc. is the sole member of LaBranche & Co. LLC and the sole stockholder of LFSI. Our subsidiary LaBranche & Co. LLC is one of the oldest and largest specialist firms on the NYSE, as well as a specialist on the AMEX. LFSI provides clearing, prime brokerage and execution services to both individual and institutional clients, including traders, professional investors and broker-dealers, direct access floor brokerage services. In addition, LFSI provides front-end order execution systems, analysis and reporting solutions for

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the wholesale securities market.

Our business has grown considerably during the past five years. We have accomplished this growth both internally and through acquisitions. Our revenues increased from \$49.9 million in 1996 to \$424.1 million in 2001, representing a compound annual growth rate of 53.4%. During the same period, we increased the number of our NYSE common stock listings from 125 to 591.

### REVENUES

Our revenues consist primarily of net gain earned from principal transactions in securities for which we act as specialist, and commissions revenue earned from specialist and clearance activities. Net gain on principal transactions represents trading gains net of trading losses and SEC transaction fees, and are earned by us when we act as principal buying and selling our specialist stocks and options. These revenues are primarily affected by changes in share volume and fluctuations in price of our specialist stocks and options. Commissions revenue consists primarily of fees we earn when our specialists act as agents to match buyers and sellers for limit orders executed by us on behalf of brokers after a specified period of time; we do not earn commissions when we match market orders. In addition, commissions revenue includes fees charged to customers for execution and clearance by our clearing subsidiaries, Henderson Brothers and RPM Clearing Corporation. Other revenue consists of interest income, fees charged to customers for use of the front-end order execution system developed by ITTI, proprietary trading revenues and earnings or losses from investments in a hedge fund and two joint specialist books. For the year ended December 31, 2001, net gain on principal transactions represented 80.4% of our total revenues, commissions revenue represented 14.8% of our total revenues, and other revenue represented 4.8% of our total revenues. The respective percentages for the prior year were 82.1%, 13.2% and 4.7%.

### EXPENSES

Our largest operating expense is employee compensation and related benefits, which primarily consist of salaries and wages and profitability-based compensation. Profitability-based

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compensation includes compensation and benefits paid to managing directors, trading professionals and other employees based on our profitability.

Prior to our reorganization from partnership to corporate form in August 1999, a large portion of the compensation payments to our managing directors had not been presented as part of operating expenses. The aggregate amount of these compensation payments generally approximated the interest of LaB Investing Co. L.L.C., formerly the general partner of LaBranche & Co., in the income of LaBranche & Co., before managing directors' compensation. Generally, these payments of compensation were allocated among our managing directors based on their respective percentage interests in the profits of LaB Investing Co. L.L.C. Subsequent to the reorganization transactions, we include payments to managing directors in employee compensation and related benefits expense. Therefore, historical income before managing directors' compensation, limited partners' interest in earnings of subsidiary and provision for income taxes for 1999 and years prior, understates our operating costs when compared to our present corporate structure.

### REORGANIZATION TRANSACTIONS

In August 1999, we reorganized from partnership to corporate form. Prior

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to the reorganization, we operated as LaBranche & Co., a limited partnership and LaB Investing Co. L.L.C., a limited liability company and the general partner of LaBranche & Co. As part of the reorganization, we redeemed limited partnership interests in LaBranche & Co. and redeemed or purchased all membership interests in LaB Investing Co. L.L.C. in exchange for a combination of cash, indebtedness and common stock of LaBranche & Co Inc. The redemption of the limited partnership interests was accounted for as a step acquisition under the purchase method of accounting. The excess of purchase price over the limited partners' capital accounts of \$127.4 million was allocated to intangible assets. Following the reorganization, LaBranche & Co Inc. became a holding corporation whose assets consisted primarily of ownership interests in LaBranche & Co. and LaB Investing Co. L.L.C. As of June 30, 2000, LaB Investing Co. L.L.C. was merged with and into LaBranche & Co. and on the same date, LaBranche & Co. converted into a limited liability company and changed its name to LaBranche & Co. LLC. As a result, LaBranche & Co Inc. became, and continues to be, the sole member of our specialist subsidiary, LaBranche & Co. LLC.

As of December 31, 2001 our Henderson Brothers and ITTI subsidiaries were merged with and into our RPM Clearing Corporation subsidiary. RPM Clearing Corporation then changed its name to LFSI in January 2002, of which LaBranche & Co Inc. is the sole shareholder.

### INCOME TAXES

As a partnership, we were not subject to U.S. federal, state and local income taxes, apart from the 4% New York City unincorporated business tax. As part of our restructuring to a corporation, we are subject to U.S. federal, state and local income taxes.

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### COMPLETED ACQUISITIONS

On March 13, 2001, we acquired all the outstanding capital stock of ITTI, a company that provides front-end order execution systems, analysis and reporting solutions for the wholesale securities dealer market. The results of the operations of ITTI have been included in our financial statements since March 14, 2001. The excess of purchase price over fair value of net tangible assets of approximately \$4.3 million was allocated to goodwill.

On March 15, 2001, we acquired RPM for an aggregate of approximately 6.9 million shares of our common stock and 100,000 shares of nonconvertible Series A preferred stock. In addition, each formerly outstanding RPM option was converted into an immediately exercisable option to purchase 98.778 shares of our common stock. The adjusted excess of purchase price over fair value of net tangible assets of approximately \$434.7 million was allocated to specialist stock list and goodwill. The results of the operations of RPM have been included in our financial statements since March 16, 2001. As a result of the exercise of replacement options granted to former RPM employees, we recorded a tax benefit not reflected through the results of operations of \$16.2 million for the year ended December 31, 2001.

On August 13, 2001, LaBranche & Co. LLC acquired all the assets relating to the AMEX stocks and options specialist operations of Cranmer for an aggregate of approximately \$9.2 million, 100,000 shares of our common stock and an amount equal to the equity capital of Cranmer, including the net value of Cranmer's open security positions on the closing date of the acquisition. The excess of purchase price over fair value of net tangible assets of approximately \$14.0 million was allocated to specialist stock list and goodwill. The results of the AMEX specialist operations formerly conducted by Cranmer have been included in

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our consolidated financial statements since August 14, 2001.

On September 20, 2001, LaBranche & Co. LLC acquired the interests in the Joint Book which it did not previously own for an aggregate of approximately \$13.6 million in cash, 54,750 shares of our common stock and an amount equal to Freedom's and Adrian's respective shares of the equity capital of the Joint Book on the closing date of the acquisition. The excess of purchase price over fair value of net tangible assets of approximately \$15.0 million was allocated to specialist stock list and goodwill. The results of the operations formerly conducted by the Joint Book in which we previously did not own an interest have been included in our consolidated financial statements since September 21, 2001.

On October 18, 2001, LaBranche & Co. LLC acquired Bocklet for an aggregate of \$20.0 million in cash, of which \$5.0 million was paid at the closing, \$5.0 million was paid on January 18, 2002 and \$5.0 million is payable on each of April 18, 2002 and July 18, 2002 and 1,100,000 shares of our common stock. In addition, an amount equal to the equity capital of Bocklet on the closing date of the acquisition will be paid in three equal installments of which approximately \$1.4 million was paid January 18, 2002 and the remaining amount will be paid six and nine months from the closing date. The excess of purchase price over fair value of net tangible assets of approximately \$53.4 million was allocated to specialist stock list and goodwill. The results of

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the operations formerly conducted by Bocklet have been included in our financial statements since October 19, 2001.

### RECENT DEVELOPMENTS

In July 2001, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 141, "Business Combinations" and No. 142, "Goodwill and Other Intangible Assets." SFAS No. 141 addresses financial accounting and reporting for goodwill and other intangible assets acquired in a business combination, requiring that the purchase method of accounting be used in all business combinations initiated after June 30, 2001. SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangible assets acquired individually or with a group of assets. The statement provides that intangible assets with indefinite useful lives will no longer be amortized, effective for fiscal years beginning after December 15, 2001 for intangible assets existing at June 30, 2001 or effective immediately for intangible assets acquired after June 30, 2001. Rather, these assets will be tested at least annually for impairment by applying a fair-value based test. In addition, intangible assets with finite useful lives continue to be amortized over their useful lives, which are no longer limited to 40 years. The provisions of SFAS No. 142 are effective for fiscal years beginning after December 15, 2001. Accordingly, commencing January 2002, we will cease amortization of recorded goodwill and intangible assets with indefinite useful lives and the amortization expense for these intangible assets will no longer be included in our results of operations. We do not anticipate incurring any impairment charges upon implementation of SFAS No. 142. However, it is possible that in the future, after periodic testing, we may incur impairment charges related to the carrying value of goodwill and intangible assets recorded in our financial statements.

In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 addresses the financial accounting and reporting for the impairment or disposal of long-lived assets. SFAS No. 144 is effective for fiscal years beginning after December 15, 2001. We do not believe the implementation of SFAS No. 144 will have a material impact on our consolidated financial statements.

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### CRITICAL ACCOUNTING POLICIES

All of our principal securities transactions and the related revenues and expenses are recorded on a trade date basis. Customer securities transactions and the related revenues and expenses are recorded on a settlement date basis, which does not differ materially from trade date basis. Securities owned and securities sold, but not yet purchased are reflected at market value and unrealized gains and losses are reflected in net gain on principal transactions.

Our balance sheet contains significant intangible assets. These intangible assets are comprised of our specialist stock lists, trade name and goodwill acquired in connection with our various acquisitions and the limited partner buyout that occurred in connection with our reorganization from partnership to corporate form in August 1999. The specialist stock lists and trade name are being amortized on a straight-line basis over 15 to 40 years and the goodwill is being amortized on a straight-line basis over 15 years. The allocations of purchase price and determinations of useful lives were based upon independent appraisals for all acquisitions

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through March 2001. In addition, the useful lives of the acquired specialist stock lists were determined based upon analysis of historical turnover characteristics of the specialist stocks comprising these lists. For acquisitions subsequent to March 2001, the allocations of purchase price and determinations of useful lives were based upon management analysis of revenues, consideration paid, common stock listings as well as other relevant data and ratios. This information was analyzed and compared to the results of the independent appraisals conducted on acquisitions prior to March 2001.

As discussed under "Recent Accounting Pronouncements", with the implementation of SFAS No. 142 we will no longer amortize goodwill and intangible assets with indefinite useful lives, which includes goodwill and trade name. Application of the non-amortization provisions of SFAS No. 142 is currently expected to result in an increase in results from operations of approximately \$28.2 million. Commencing 2002, we will perform periodic impairment tests on these assets to determine if there is a need to write them down. We do not anticipate incurring any impairment charges upon implementation of SFAS No. 142, but it is possible that in the future the carrying value of our goodwill and intangible assets may be reduced.

### REPURCHASE OF OUR PREFERRED STOCK

On January 18, 2002, we offered to repurchase up to 30,000 shares of our outstanding Series A preferred stock for \$1,000 per share, plus accrued and unpaid dividends up to but not including the date of purchase. On February 15, 2002, the offer expired, and on February 19, 2002, we purchased all the approximately 28,164 shares that had been tendered for approximately \$28.5 million, including accrued but unpaid dividends. As a result of the purchase, we recorded a one-time expense due to the acceleration of the discount accretion on the shares purchased of approximately \$1.5 million.

### TRUST DECS OFFERING

On February 8, 2002, certain managing directors of LaBranche & Co. LLC entered into prepaid forward contracts with DECS Trust IX, a statutory business trust, pursuant to which the trust agreed to purchase from the participating managing directors, on a date which is expected to be February 8, 2005, an aggregate of 3,800,000 shares of our common stock owned by these managing

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directors, subject to the terms and conditions set forth in the contracts. The trust concurrently sold 3,800,000 trust securities, known as DECS, to investors. We did not receive, nor will we receive, any portion of the proceeds from the sale of shares pursuant to the contracts or from the sale of the DECS. The participating managing directors bore responsibility for payment of the expenses incurred by them in connection with this transaction.

### RESULTS OF OPERATIONS

The following table sets forth the statement of operations data for the years indicated as a percentage of total revenues:

|   | FOR THE<br>2001<br>---- |
|---|-------------------------|
| <b>REVENUES:</b>  |                         |
| Net gain on principal transactions .....  | 80.4                    |
| Commissions .....   | 14.8                    |
| Other .....   | 4.8                     |
|   | -----                   |
| Total revenues .....  | 100.0                   |
|   | -----                   |
| <b>EXPENSES:</b>  |                         |
| Employee compensation and related benefits .....  | 26.1                    |
| Interest .....  | 12.3                    |
| Depreciation and amortization of intangibles .....  | 9.3                     |
| Exchange, clearing and brokerage fees .....   | 5.3                     |
| Lease of exchange memberships .....   | 4.8                     |
| Legal and professional fees .....   | 1.2                     |
| Communications .....  | 1.1                     |
| Occupancy .....   | 0.9                     |
| Other .....   | 2.0                     |
|   | -----                   |
| Total expenses before managing directors' compensation, limited partners' interest in earnings of subsidiary and provision for income taxes ..... | 63.0                    |
|   | -----                   |
| Income before managing directors' compensation, limited partners' interest in earnings of subsidiary and provision for income taxes .....         | 37.0                    |
| MANAGING DIRECTORS' COMPENSATION .....  | --                      |
|   | -----                   |
| Income before limited partners' interest in earnings of subsidiary and provision for income taxes .....   | 37.0                    |
| LIMITED PARTNERS' INTEREST IN EARNINGS OF SUBSIDIARY .....  | --                      |
|   | -----                   |
| Income before provision for income taxes .....  | 37.0                    |
| PROVISION FOR INCOME TAXES .....  | 20.1                    |
|   | -----                   |
| Net income .....  | 16.9                    |
|   | =====                   |

YEAR ENDED DECEMBER 31, 2001 COMPARED TO YEAR ENDED DECEMBER 31, 2000

### REVENUES

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Total revenues increased 23.0% to \$424.1 million for 2001, from \$344.8 million for 2000, principally due to the increase in revenue from net gain on principal transactions. Net gain on principal transactions increased 20.5% to \$340.8 million for 2001, from \$282.9 million for 2000. This increase was due to the RPM, Joint Book and Bocklet acquisitions in March, September and October 2001, respectively, as a result of which we became the specialist for 218 additional common stock listings. In addition, increased share volume in principal trading in our specialist stocks traded on the NYSE also contributed to the increase in revenue. Our share volume as principal increased 51.1% to 27.2 billion shares for 2001, from 18.0 billion shares for 2000.

Commissions revenue increased 38.5% to \$62.9 million for 2001, from \$45.4 million for 2000. This increase was primarily due to an increase in commissions and clearance revenue earned by our Henderson Brothers and RPM Clearing Corporation subsidiaries. The share volume executed by us as agent in our specialist stocks increased 10.7% to 6.2 billion shares for 2001, from 5.6 billion shares for 2000. Despite the increase in share volume, competitive price pressures within the marketplace mitigated the increases in our clearance revenue.

Other revenue increased 24.2% to \$20.5 million for 2001, from \$16.5 million for 2000. This increase was primarily due to the revenues earned by our ITTI and RPM Clearing Corporation subsidiaries, as well as an increase in our interest income due to the investment of

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additional funds. These gains were offset by losses incurred by our investments in a hedge fund, joint trading books as well as other non-marketable investments.

### EXPENSES

Total expenses before managing directors' compensation, limited partners' interest in earnings of subsidiary and provision for income taxes increased 50.1% to \$267.4 million for 2001 from \$178.2 million in 2000.

Employee compensation and related benefits increased 24.8% to \$110.8 million for 2001, from \$88.8 million for 2000. This increase was due to the RPM, Bocklet and other 2001 acquisitions, which increased our average headcount for the year by approximately 226 individuals. As a percentage of total revenues, employee compensation increased to 26.1% of total revenues for 2001, from 25.7% of total revenues for 2000.

Interest expense increased 24.1% to \$52.0 million for 2001, from \$41.9 million for 2000. This increase was primarily due to the assumption of approximately \$17.4 million and \$9.0 million of promissory notes and secured demand notes, respectively, in connection with the RPM acquisition. As of December 31, 2001, approximately \$14.1 million of the promissory notes were outstanding as the result of scheduled repayments throughout the year. The issuance of \$16.4 million of subordinated indebtedness in connection with the Bocklet acquisition also contributed to the increase. In addition, the increase was due to a full year of interest expense on \$250.0 million of indebtedness, incurred in connection with the Henderson Brothers and Webco acquisitions. As a percentage of total revenues, interest expense increased to 12.3% of total revenues for 2001, from 12.2% of total revenues for 2000.

Depreciation and amortization of intangibles expense increased 113.5% to \$39.5 million for 2001, from \$18.5 million for 2000. Amortization of intangibles

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increased as a result of the \$434.7 million of intangible assets recorded as a result of our acquisition of RPM. As a percentage of total revenues, depreciation and amortization of intangibles expense increased to 9.3% of total revenues for 2001, from 5.4% of total revenues for 2000.

Exchange, clearing and brokerage fees expense increased 339.2% to \$22.4 million for 2001, from \$5.1 million for 2000. This increase was primarily due to a new NYSE allocation fee, requiring specialist firms to share the cost of newly allocated listings on the NYSE, an increase in NYSE regulatory fees based on exchange seat use, an increase in exchange and brokerage fees related to our expanded execution and clearing business and an increase in trading volumes as a result of the RPM, Bocklet and other 2001 acquisitions. As a percentage of total revenues, exchange, clearing and brokerage fees expense increased to 5.3% of total revenues for 2001, from 1.5% of total revenues for 2000.

Lease of exchange memberships expense increased 88.1% to \$20.5 million for 2001, from \$10.9 million for 2000. This increase was due to the increase in the number of our NYSE leased memberships from 50 to 80, and to an increase in the average annual leasing cost of a membership from approximately \$276,000 to \$312,000. In addition, we also leased eight AMEX seats during 2001 as a result of the Cranmer acquisition. As a percentage of total revenues lease

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of exchange memberships expense increased to 4.8% of total revenues for 2001, from 3.2% of total revenues for 2000.

Legal and professional fees increased 163.2% to \$5.0 million for 2001, from \$1.9 million for 2000. This increase was primarily the result of professional fees incurred by our acquired subsidiaries ITTI and RPM Clearing Corporation, as well as an increase in legal, accounting and other professional fees in our existing businesses.

Communications expense increased 220.0% to \$4.8 million for 2001, from \$1.5 million for 2000. This increase was primarily the result of additional telephone, data retrieval and informational services utilized due to the growth of our business.

Occupancy expense increased 200.0% to \$3.9 million for 2001, from \$1.3 million for 2000. This increase was primarily the result of additional leased office space acquired in connection with the RPM acquisition as well as the general expansion of our business.

Other expenses increased 2.4% to \$8.5 million for 2001, from \$8.3 million for 2000. This increase was primarily due to an increase in advertising and promotional costs, and increased charitable contributions.

INCOME BEFORE MANAGING DIRECTORS' COMPENSATION, LIMITED PARTNERS' EARNINGS IN INTEREST OF SUBSIDIARY AND PROVISION FOR INCOME TAXES

Income before managing directors' compensation, limited partners' interest in earnings of subsidiary and before provision for income taxes decreased 5.9% to \$156.7 million for 2001, from \$166.6 million for the same period in 2000. This decrease was primarily due to an increase in employee compensation and related benefits expense, depreciation and amortization of intangibles, exchange, clearing and brokerage fees and other expenses as a result of our acquisitions in 2001, which was offset by an increase in revenues as a result of those acquisitions.

INCOME TAXES

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Provision for income taxes increased 0.5 % to \$85.1 million for 2001, from \$84.7 million for 2000, due to an increase in nondeductible amortization of intangibles -- despite a decrease in income before provision for income taxes.

YEAR ENDED DECEMBER 31, 2000 COMPARED TO YEAR ENDED DECEMBER 31, 1999

### REVENUES

Total revenues increased 71.5% to \$344.8 million for 2000, from \$201.0 million for 1999, principally due to the increase in revenue from net gain on principal transactions. Net gain on principal transactions increased 87.4% to \$282.9 million for 2000, from \$151.0 million for 1999. This increase was primarily due to the Henderson Brothers and Webco acquisitions in March 2000, as a result of which we became the specialist for 147 additional common stock listings, as well as increased share volume in principal trading in our specialist stocks traded on

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the NYSE. Our share volume as principal increased 87.5% to 18.0 billion shares for 2000, from 9.6 billion shares for 1999.

Commissions revenue increased 22.0% to \$45.4 million for 2000, from \$37.2 million for 1999. This increase was primarily due to the increase in the number of our common stock listings as a result of the Henderson Brothers and Webco acquisitions and to increased share volume in our specialist stocks traded on the NYSE in which we acted as agent. The share volume executed by us as agent in our specialist stocks increased 36.6% to 5.6 billion shares for 2000, from 4.1 billion shares for 1999.

Other revenue increased 28.9% to \$16.5 million for 2000, from \$12.8 million for 1999. This increase was primarily due to an increase in our interest income, which was also offset by a decrease in our proprietary trading revenues and other investments.

### EXPENSES

Total expenses before managing directors' compensation, limited partners' interest in earnings of subsidiary and provision for income taxes increased 167.6% to \$178.2 million for 2000 from \$66.6 million for 1999.

Employee compensation and related benefits increased 158.9% to \$88.8 million for 2000, from \$34.3 million for 1999. This increase was primarily due to the inclusion of managing directors' salary, incentive-based compensation and related benefits in employee compensation subsequent to our reorganization, and due to the Henderson Brothers and Webco acquisitions that resulted in our employment of 97 additional individuals as of the respective acquisition dates. As a percentage of total revenues, employee compensation increased to 25.7% of total revenues for 2000, from 17.0% of total revenues for 1999.

Interest expense increased 404.8% to \$41.9 million for 2000, from \$8.3 million for 1999. This increase was primarily due to the issuance, in connection with the Henderson Brothers and Webco acquisitions, of \$250.0 million of indebtedness that began accruing interest on March 2, 2000. In addition, the increase was due to the issuance of \$116.4 million of indebtedness, in connection with our reorganization, that began accruing interest from August 24, 1999. As a percentage of total revenues, interest increased to 12.2% of total revenues for 2000, from 4.1% of total revenues for 1999.

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Depreciation and amortization of intangibles expense increased 262.8% to \$18.5 million for 2000, from \$5.1 million for 1999. Amortization of intangibles increased as a result of the \$233.7 million of intangible assets recorded as a result of our acquisition of Henderson Brothers and Webco and incurring a full year of amortization of intangibles in 2000 related to the redemption of limited partnership interest in 1999. As a percentage of total revenues, depreciation and amortization of intangibles increased to 5.4% of total revenues for 2000, from 2.5% of total revenues for 1999.

Exchange, clearing and brokerage fees consist primarily of fees paid by us as a specialist to the NYSE and to clearing houses. Fees paid by us to the NYSE primarily include fees based on the volume of transactions executed as principal and as agent, as well as a flat annual fee.

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Exchange, clearing and brokerage fees expense increased 41.7% to \$5.1 million for 2000, from \$3.6 million for 1999. This increase was primarily due to the increased trading volumes as a result of the Henderson Brothers and Webco acquisitions.

Lease of exchange memberships expense increased 29.8% to \$10.9 million for 2000, from \$8.4 million for 1999. This increase was due to the increase in the number of leased memberships from 44 to 50, and was also due to an increase in the average annual leasing cost of a membership from approximately \$192,000 to \$276,000. As a percentage of total revenues, however, lease of exchange memberships decreased to 3.2% of total revenues for 2000, from 4.2% of total revenues for 1999.

Legal and professional fees increased 18.8% to \$1.9 million for 2000, from \$1.6 million for 1999. This increase was primarily the result of increased legal and filing fees associated with various filings and acquisitions.

Communications expense increased 25.0% to \$1.5 million for 2000, from \$1.2 million for 1999. This increase was primarily the result of additional telephone, data retrieval and informational services utilized due to the growth of our business.

Occupancy expense increased 30.0% to \$1.3 million for 2000, from \$1.0 million for 1999. This increase was primarily the result of the leasing of additional office space due to the Henderson Brothers and Webco acquisitions.

Other expenses increased 176.7% to \$8.3 million for 2000, from \$3.0 million for 1999. This increase was primarily due to additional fees incurred in connection with the increase and extension of our line-of-credit with a U.S. commercial bank, increased charitable contributions, as well as an increase in advertising and promotional costs.

INCOME BEFORE MANAGING DIRECTORS' COMPENSATION, LIMITED PARTNERS' EARNINGS IN INTEREST OF SUBSIDIARY AND PROVISION FOR INCOME TAXES

Income before managing directors' compensation, limited partners' interest in earnings of subsidiary and before provision for income taxes increased 23.9% to \$166.6 million for 2000, from \$134.5 million for the same period in 1999. This increase was primarily due to the additional revenues generated by the Henderson Brothers and Webco acquisitions which was offset by the inclusion of managing directors' salary and incentive-based compensation in employee compensation and related benefits and the additional interest and amortization of intangibles expense as a result of the acquisitions.

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### INCOME TAXES

Provision for income taxes increased 254.4% to \$84.7 million for 2000, from \$23.9 million for 1999, as a result of a full year of federal, state and local income taxes to which we are subject as a result of our reorganization from partnership to corporate form in 1999 and our increased profitability.

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### LIQUIDITY

As of December 31, 2001, we had \$2,000.8 million in assets, of which \$189.5 million consisted of cash and short-term investments primarily in government obligations and commercial paper maturing within three months, cash and securities segregated under federal regulations and overnight repurchase agreements. As of December 31, 2000, we had \$1,004.1 million in assets, of which \$287.6 million consisted of cash and short-term investments primarily in commercial paper maturing within three months and overnight repurchase agreements.

In January 2001, LaBranche & Co. LLC extended our \$200.0 million line-of-credit with a U.S. commercial bank until February 1, 2002 and extended it again in February 2002 until February 27, 2003. Amounts outstanding under the U.S. commercial bank credit facility would be secured by our inventory of specialist stocks and bear interest at the U.S. commercial bank's broker loan rate. To date, we have not utilized this facility. In order to maintain the availability of funds under this credit facility, we must comply with certain customary covenants.

As of December 31, 2001 and 2000, the subordinated indebtedness of LaBranche & Co. LLC aggregated \$66.0 million and \$41.9 million (excluding subordinated liabilities related to contributed exchange memberships), respectively. The \$66.0 million of outstanding subordinated indebtedness of LaBranche & Co LLC on December 31, 2001 consisted of the following:

- o \$35.0 million in senior subordinated notes,
  - o \$20.0 of which were privately placed pursuant to note purchase agreements, mature on September 15, 2002 and bear interest at an annual rate of 8.17%, payable on a quarterly basis; and
  - o \$15.0 million of which were privately placed pursuant to note purchase agreements, mature on June 3, 2008 and bear interest at an annual rate of 7.69%, payable on a quarterly basis.
- o \$31.0 million in junior subordinated notes,
  - o \$8.0 million of which were issued to former limited partners, family members of former employees and former equity owners of Bocklet and their respective family members. These notes mature on varying dates between the second half of 2002 and the first half of 2003 and bear interest at annual rates between 8.0% and 10.0%, payable on a quarterly basis;
  - o \$9.0 million in secured demand note obligations which were assumed by LaBranche & Co. LLC in connection with our acquisition of RPM, \$1.0 million matures in April 2003 and \$8.0 million matures in June 2003 and bear interest at adjusting variable rates, payable monthly; and

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- o \$14.0 million in secured demand note obligations to two former members of Bocklet, which were incurred in connection with our acquisition of

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Bocklet, bear interest at an annual rate of 10% and mature in October 2002.

The junior subordinated notes have automatic rollover provisions, which extend the maturities for an additional year, unless the lender provides at least seven months' advance notice prior to maturity. LaBranche & Co. LLC is also entitled to prepay the junior subordinated notes and the secured demand note obligations without penalty under the terms of the agreements relating thereto.

As of December 31, 2001, we had an aggregate of \$14.1 million of indebtedness outstanding, which we had assumed in connection with the RPM acquisition and which consisted of:

- o \$3.0 million in subordinated notes issued to family members of former employees of RPM maturing between the first half of 2002 and the first half of 2006 and bearing interest at an annual rate of between 9.0% and 12.5%, payable on a quarterly basis;
- o a \$295,000 promissory note which has an automatic rollover provision that extends the maturity for an additional year, unless the lender provides notice at least 30 days prior to maturity, and which bears interest at an annual rate of 9.0% payable on a quarterly basis;
- o \$8.5 million in promissory notes issued to former RPM employees and their family members. These notes are payable in equal annual installments on the anniversaries of issuance, mature between the second half of 2002 and the first half of 2005, and bear interest at annual rates ranging from 8.0% to 12.0%, payable on a quarterly basis; and
- o \$2.3 million in notes representing deferred compensation owed to former RPM employees. These notes are payable in equal annual installments on the anniversaries of issuance, mature between the second half of 2002 and the second half of 2004 and bear interest at annual rates ranging from 9.5% to 10.0% payable on a quarterly basis.

In connection with our acquisition of RPM, we issued 100,000 shares of our nonconvertible Series A preferred stock to the former stockholders of RPM. Each outstanding share of our Series A preferred stock entitles the holder to cumulative preferred cash dividends at an annual rate of 8% of the liquidation preference per share until the fourth anniversary of the closing of the merger, 10% until the fifth anniversary of the closing, and 10.8% thereafter. Dividends are payable on the first day of January and the first day of July of each year (or if such date is not a regular business day, then the next business day thereafter), with the first payment made on July 1, 2001. Dividends on the issued and outstanding shares of Series A preferred stock are preferred and cumulative and accrue daily from the date on which they were originally issued. On January 18, 2002, we offered to repurchase up to 30,000 shares of our outstanding Series A preferred stock for \$1,000 per share, plus accrued and unpaid dividends up to but not including the date of purchase. On February 15, 2002, the offer expired, and on February 19, 2002 we

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purchased all the approximately 28,164 shares that had been tendered for a purchase price of approximately \$28.5 million including accrued but unpaid dividends. As of February 28, 2002, 71,836 shares of our Series A preferred stock were outstanding.

On August 24, 1999, we issued \$100.0 million aggregate principal amount of Senior Notes. The Senior Notes bear interest at a rate of 9 1/2% annually and mature in August 2004. The indenture covering the Senior Notes includes certain covenants that, among other things, limit our ability to borrow money, pay dividends on our stock or purchase our stock, make investments, engage in transactions with stockholders and affiliates, create liens on our assets, and sell assets or engage in mergers and consolidations, except in accordance with certain specified conditions.

On August 24, 1999, in connection with our reorganization from partnership to corporate form, we issued a \$16.0 million senior note as partial payment for the acquisition of a certain limited partnership interest in LaBranche & Co. LLC (prior to its conversion to a limited liability company). The note is payable in three annual installments, with \$11.0 million of the aggregate principal amount already having been paid on the first and second anniversaries of issuance. The remaining \$5.0 million principal amount is payable on the third anniversary of issuance, and bears interest at the annual rate of 9.5%.

On March 2, 2000, we issued \$250.0 million aggregate principal amount of Senior Subordinated Notes. These Senior Subordinated Notes bear interest at a rate of 12.0% annually and mature in March 2007. The indenture covering the Senior Subordinated Notes includes certain covenants that, among other things, limit our ability to borrow money, pay dividends on our stock or purchase our stock, make investments, engage in transactions with stockholders and affiliates, create liens on our assets, and sell assets or engage in mergers and consolidations, except in accordance with certain specified conditions.

The Senior Subordinated Notes also require us, within 150 days after the end of each fiscal year, to offer to redeem from all holders of the Senior Subordinated Notes a principal amount equal to our Excess Cash Flow at a price equal to 103.0% of the principal amount being offered for purchase plus accrued and unpaid interest, if any, to the date of redemption. Each holder is entitled to be offered his or her pro rata share based upon his or her ownership percentage of the outstanding Senior Subordinated Notes. Excess Cash Flow is defined for this purpose as 40% of the amount by which our consolidated EBITDA exceeds the sum of our interest expense, tax expense, increase in net capital or net liquid asset requirements, capital expenditures, any cash amounts related to acquisitions of NYSE specialists or any cash payments related to our payment at maturity of the principal amount of our existing or certain other indebtedness. On April 12, 2001, we offered to purchase approximately \$9.9 million aggregate principal amount of our Senior Subordinated Notes based on our Excess Cash Flow for the year ending December 31, 2000. This offer expired on May 22, 2001 without the tender of any Senior Subordinated Notes. For the year ending December 31, 2001, we did not have Excess Cash Flow, as defined for this purpose.

In connection with the Webco acquisition on March 9, 2000, we issued unsecured senior promissory notes in the aggregate principal amount of \$3.0 million to the stockholders of Webco. These notes bear interest at an annual rate of 10.0%. Of the aggregate principal amount,

\$500,000 was repaid during 1999, and the balance, plus all accrued interest, was paid in full on September 9, 2001.

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As a broker-dealer, LaBranche & Co. LLC is subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers and requiring the maintenance of minimum levels of net capital, as defined in SEC Rule 15c3-1. 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. NYSE Rule 326(c) also prohibits a broker-dealer from repaying subordinated borrowings, paying cash dividends, making loans to any parent, affiliates or employees, or otherwise entering into transactions which would result in a reduction of its total net capital to less than 150% of its required minimum capital. Moreover, broker-dealers are required to notify the SEC prior to repaying subordinated borrowings, paying dividends and making loans to any parent, affiliates or employees, or otherwise entering into transactions which, if executed, would result in a reduction of 30% or more of their excess net capital (net capital less minimum requirement). The SEC has the ability to prohibit or restrict such transactions if the result is deemed detrimental to the financial integrity of the broker-dealer.

At December 31, 2001, LaBranche & Co. LLC had net capital of \$484.2 million, which was \$481.4 million in excess of its required net capital of \$2.9 million. At December 31, 2000, LaBranche & Co. LLC had net capital of \$293.4 million, which was \$290.3 million in excess of its required net capital of \$3.1 million.

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. Under changes to Rule 104, effective October 30, 2000, specialist units that exceed five percent in any of the NYSE's four concentration measures must maintain minimum net liquid assets based upon the securities for which they act as the specialist. The requirements state that the net liquid assets must be equivalent to \$4.0 million for each stock in the Dow Jones Industrial Average, \$2.0 million for each stock in the S&P 100 Stock Price Index, excluding stocks included in the previous classification, \$1.0 million for each stock in the S&P 500 Stock Price Index, excluding stock included in the previous classifications, \$500,000 for each common stock, excluding bond funds and stocks included in the previous classifications, and \$100,000 for each stock not included in any of the above classifications. In addition, the NYSE requires any new specialist entities that result from a merger, acquisition, consolidation or other combination of specialist entities to maintain net liquid assets equivalent to the greater of either: (1) the aggregate net liquid assets of the specialist entities prior to their combination or (2) the new capital requirements prescribed under Rule 104. Net liquid assets for a specialist who also engages in transactions other than specialist activities is based upon its excess net capital as determined in accordance with SEC Rule 15c3-1. Currently, LaBranche & Co. LLC's net liquid asset requirement is \$446.0 million. As of December 31, 2001, LaBranche & Co. LLC's actual net liquid assets were approximately \$491.5 million. As of December 31, 2000, LaBranche & Co. LLC's NYSE minimum required dollar amount of net liquid assets was \$284.3 million compared to actual net liquid assets of approximately \$305.0 million.

Failure to maintain the required net capital and net liquid assets may subject us to suspension or revocation of SEC registration or suspension or expulsion by the NYSE.

Additionally, as registered broker-dealers and member firms of the NYSE, our former Henderson Brothers and RPM Clearing Corporation subsidiaries were subject to SEC Rule 15c3-1 as adopted and administered by the NYSE and the SEC.

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Under the alternative method permitted by the rule, the minimum required net capital shall be equal to the greater of \$250,000 or 2% of aggregate debit items as defined. As of December 31, 2001, the combined net capital of these subsidiaries as defined under SEC Rule 15c3-1 was \$20.5 million which exceeded minimum requirements by \$19.7 million.

As clearing broker-dealers, our former Henderson Brothers subsidiary and our RPM Clearing Corporation subsidiary 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 these subsidiaries as allowable assets in the correspondents' net capital calculation. At December 31, 2001, the combined reserve requirement of these subsidiaries was approximately \$23.3 million. Additionally, these subsidiaries have combined cash and securities on deposit in a special reserve bank account of \$24.8 million as of January 3, 2002, to comply with the December 31, 2001 requirement.

We currently anticipate that our available cash resources and credit facilities will be sufficient to meet our working capital, regulatory capital and capital expenditure requirements through the end of 2002.

As of December 31, 2001, the scheduled maturities of our obligations, assuming any available roll-over provisions were inapplicable, were (000's omitted):

TOTAL