

Broker-Dealer Focus

Freeman & Co. LLC

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Indices at July 29, 2005:

DJIA	10,641
NASDAQ	2,185
S&P 500	1,234
FTSE 100	5,282
10 Year US Treasury Bond Yield	4.29%
Dollar to Euro	\$1.21

Landmark Deals Signal Continued Growth of Electronic Trading Flow

Acquisition activity involving securities firms was robust during the first half of 2005, during which time 51 transactions were announced, equaling the number of acquisitions announced for the same time period in 2004. Many of the most noteworthy deals were focused on electronic trading and direct market access businesses. The New York Stock Exchange's announced acquisition of Archipelago and Nasdaq's acquisition of Instinet Group were among the most notable. The NYSE's acquisition of Archipelago, which acquired the Pacific Stock Exchange earlier this year, suggests that talk of physical stock exchanges becoming less relevant might be more than just the apocalyptic gossip of floor traders. Though the NYSE is now poised to be a major force, Nasdaq's acquisition of Instinet will help it maintain a sound position in a marketplace that stands to become increasingly competitive.

Commission flow businesses in general were an area of increased interest. In addition to the landmark deals mentioned above, Merrill Lynch and Citadel Investment Group each bought a stake in one of the US' largest options exchanges when they invested in the Philadelphia Stock Exchange. JP Morgan announced its entrance into the direct market access space through its acquisition of Neovest Holdings, Inc., e-broker Ameritrade acquired one of its largest rivals when it bought TD Waterhouse and Citigroup bolstered its brokerage capabilities by swapping its asset management business for Legg Mason's brokerage unit. With such major strategic moves occurring in the past six months, we expect the securities landscape to continue to transform as laggards catch up to their more aggressive competitors.

Summary

Our key findings are:

- There were a total of 51 acquisitions involving broker-dealer firms in 1H 2005, on par with 1H 2004 while representing an increase of 46% over 1H 2003's total of 35
- US firms accounted for 27 of the companies acquired during the first half, followed by European firms with 13 and Asian firms with 9
- The majority of acquisitions (23) involved traditional research, sales & trading firms with institutional brokerages comprising 19 of the 23 targets
- 11 electronic trading firms and exchanges were acquired in 1H 2005. Exchanges witnessed a surge in activity with significant transactions involving key players such as the NYSE, Nasdaq, Archipelago, the Pacific Exchange, and the Philadelphia Stock Exchange being announced
- The top three securities firms acquisitions of first half of 2005 ranked by total entity value were 1) Ameritrade's acquisition of TD Waterhouse USA (\$2.3 billion), 2) NYSE's acquisition of Archipelago (\$1.69 billion^[1]) and 3) Nasdaq's acquisition of Instinet's Electronic Trading Network (\$934.5 million)

[1] Enterprise Value of Archipelago Holdings as of August 4, 2005

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Global Acquisition Activity

Global acquisition activity in the broker-dealer space remained stable during the first half of 2005. Once again the US led all regions in the number of firms acquired with 27. This matches the total number of US firms acquired during the first half of 2004, a year that ultimately saw 43 US firms acquired. US Acquisition activity remained 69% above 1H 2003 levels when 16 companies were acquired.

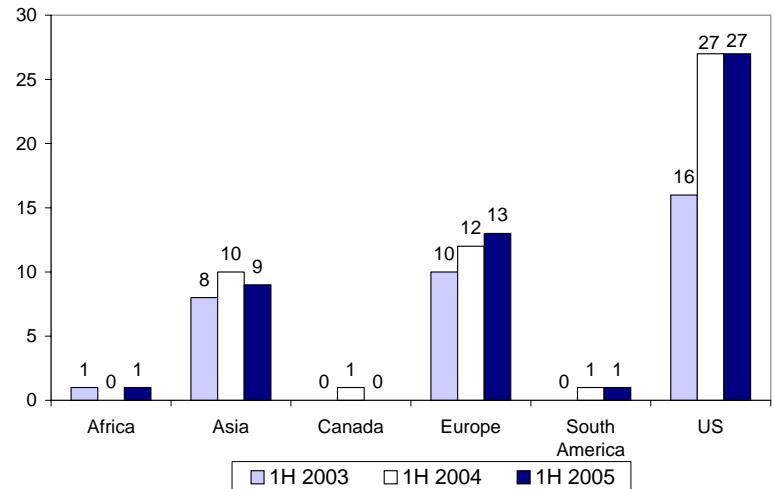
13 European firms were acquired in 1H 2005, which outpaces 1H 2004 levels by 1 transaction and represents a 30% increase over 1H 2003's total of 10 acquisitions. At the current pace, 26 European firms will be acquired by year-end 2005; however, transactions involving European targets accelerated in the second half of 2004 with 17 of the 29 total transactions occurring in the third and fourth quarters.

The first quarter of 2005 was slightly more active on the acquisition front than the second quarter with 27 and 24 deals being announced, respectively; however, the number of deals announced in Q2 2005 (24) still managed to outpace Q2 2004 by approximately 26% and Q2 2003 by over 41%.

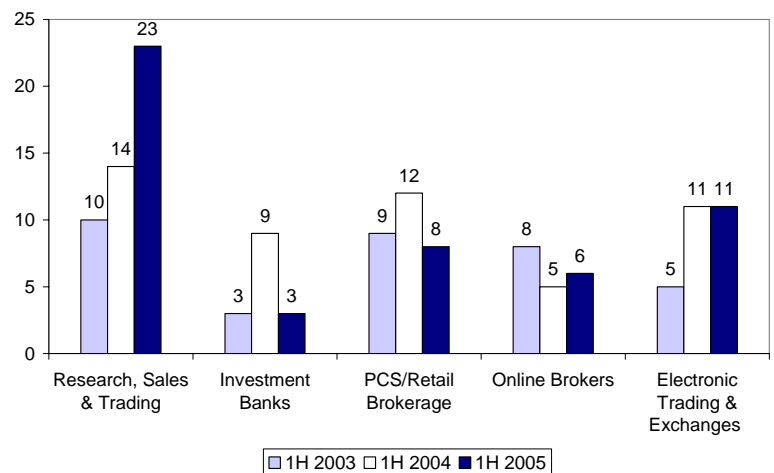
The most sought after targets in the broker-dealer space thus far in 2005 can broadly be defined as Research, Sales and Trading firms. 23 such firms have been acquired in the first two quarters, more than double the second most popular category, Electronic Trading & Exchanges. Nevertheless, there was considerable activity in the Electronic Trading and Exchange area during the first half with 11 such acquisitions being announced. These transactions included industry transforming deals between the NYSE and Archipelago and Instinet and Nasdaq.

Institutional Brokerages were in high demand in the first half and comprised the majority of the 23 Research, Sales and Trading firms acquired. Among the most notable transactions was Instinet's sale of its institutional brokerage business to private equity firm Silver Lake Partners as part of the previously mentioned Instinet/Nasdaq deal. This marked the continuation of a trend among private equity shops to become involved in the broker-dealer space that was highlighted earlier in the year when a consortium of brand name sponsors jointly acquired SunGard Data Systems for an eye-opening \$10.4 billion. This transaction marked the largest LBO of a firm in the broker-dealer space ever and the second largest buyout of any firm after KKR's \$25 billion takeover of RJR Nabisco in 1988.

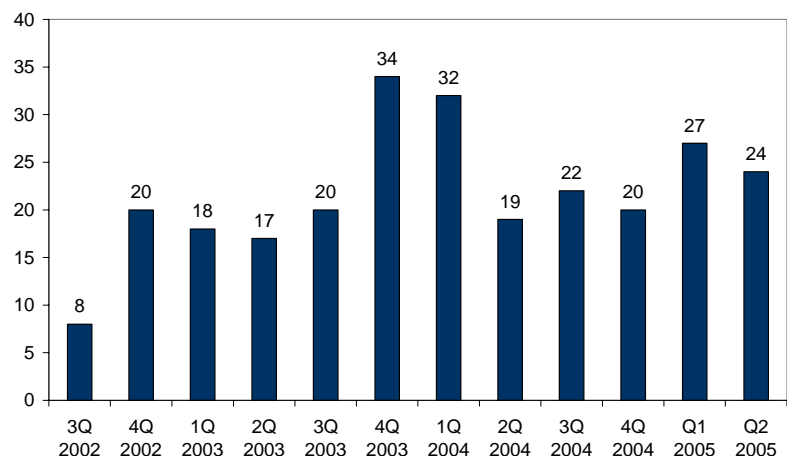
Number of Acquisitions by Seller Region



Number of Acquisitions by Firm Type



Number of Acquisitions by Quarter



Source: Freeman & Co.

US Acquisitions

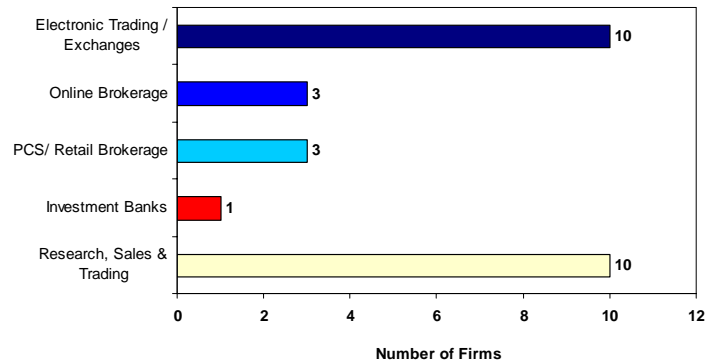
There were 51 total acquisitions in the first half of 2005. 27, or 53%, involved US firms as the target. 27 US firms were acquired in the first half of 2004 as well, also representing 53% of the total number of firms acquired during that period (51). The Electronic Trading and Exchange area remained very active with 10 firms being acquired. Research, Sales & Trading firms also proved to be attractive targets with an equal amount being acquired thus far in 2005.

Perhaps the most notable acquisition in the Electronic Trading and Exchange area to date took place during the first quarter of 2005 when the NYSE announced the acquisition of Archipelago. Upon completion, the transaction will catapult the NYSE into the world of electronic trading; long a taboo subject among the firm's specialists and floor brokers who worry that their jobs will be rendered obsolete in a more electronic environment. Regardless of these concerns, as electronic trading continues to capture an increasingly large portion of the market, the NYSE can ill-afford to stay on the sidelines if it is to remain competitive. The financial terms of the deal remain subject to change although Archipelago shareholders are guaranteed a 30% stake in the new company, NYSE Group. Additionally, Nasdaq announced the acquisition of Instinet which will help bolster its competitive position as the NYSE moves to solidify its entrenchment in the electronic trading arena.

On the online brokerage front there were 3 firms acquired in the first half of 2005, which matched the number acquired during the first half of 2004. This business has suffered during the past several years as commissions and flows declined significantly. Due to turbulent market conditions, the number of do-it-yourselfers diminished substantially. The most notable acquisition in the space in some time occurred this year when Ameritrade announced on June 22 that it would purchase rival online brokerage TD Waterhouse for \$2.9 billion in stock and re-brand the company as 'TD Ameritrade'. Rival E*Trade now becomes the focus of heightened speculation as it will likely have to make a significant move of its own in order to compete with the merged TD Ameritrade. E*Trade approached Ameritrade earlier in the quarter regarding a potential transaction, but its offer was rebuffed by Ameritrade shareholders. The online brokerage industry has yet to see trading volumes return to the levels reached during the tech boom. As such, many online brokerages have excess capacity on their existing platforms and are seeking to increase trading volume by adding customers via acquisition.

One of the most prominent transactions in the traditional brokerage space during the first part of 2005 occurred when Citigroup agreed to swap its asset management business for Legg Mason's private client-brokerage and capital markets-business in a deal valued at \$3.7 billion. The deal allows Citigroup, which has been subject to a variety of regulatory inquiries as of late, to rid itself of a potential conflict of interest associated with retail brokers pushing proprietary investment products such as in-house mutual funds. Additionally, Citigroup will more closely rival Merrill Lynch as one of the world's largest brokerage forces. Legg Mason stands to benefit substantially from the deal as well. Long considered a regional power in the asset management industry, Legg Mason now becomes a pure player in the space and will have access to Citigroup's broad retail distribution networks, providing the firm with a global platform from which to market its array of products.

Types of US Firms Acquired in 1H 2005



Top Ten US Transactions based on Entity Value (1H 2005)

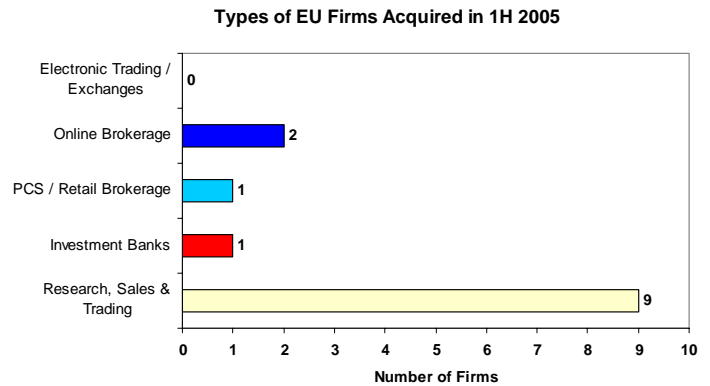
Rank	Qtr.	Year	Target	Target Firm Type	Target Country	Acquirer	Acquirer Firm Type	Entity Value \$MM
1	1	2005	SunGard Data Systems, Inc.	Financial Technology	US	Consortium of Buyout Firms	Private Equity	\$ 10,400.0
2	2	2005	TD Waterhouse USA	Retail Brokerage	US	Ameritrade Holding Corp.	E-Finance	2,300.0
3	2	2005	Instinet Group, Inc's Electronic Trading Network	Direct Access	US	Nasdaq Stock Market	Exchange	934.5
4	2	2005	Cargill's Investor Services Business	Institutional Brokerage	US	Refco Group, Ltd.	Institutional Brokerage	400.0
5	2	2005	Instinet's Institutional Brokerage	Institutional Brokerage	US	Silver Lake Partners	Private Equity	207.5
6	2	2005	Creditex, Inc	ECN	US	TA Associates	Private Equity	200.0
7	2	2005	Philadelphia Stock Exchange	Exchange	US	Merrill Lynch & Co.	Global Investment Bank	75.0
8	2	2005	Philadelphia Stock Exchange	Exchange	US	Citadel Investment Group LLC	Asset Manager	75.0
9	1	2005	Pacific Exchange, Inc.	Exchange	US	Archipelago Holdings, Inc.	Exchange	65.0
10	1	2005	Bridge Trading Co.	Institutional Brokerage	US	Instinet Group, Inc.	ECN	22.9

Source: Freeman & Co.

Note: In instances where the equity purchased was less than 100% Entity Value has been derived from the purchase price and percentage acquired

European Acquisitions

There were a total of 13 European firms acquired in the first half of 2005, which exceeds the number of firms acquired in Europe in the first half of 2004 (12) by 8.3%. European targets have comprised over 25% of the firms acquired globally thus far in 2005, a slight increase over 2004's first half rate. Research, Sales & Trading firms remained popular targets in Europe as they did in the US with 9 such European firms being acquired in 1H 2005. Electronic Trading firms and Exchanges, the most sought after European targets in 2004, saw demand fade considerably in 1H 2005. The number of European Online Brokerages acquired during 1H 2005 matches the number acquired during the same period of 2004 while activity in the PCS / Retail Brokerage space and the Investment Banking space is off 2004's pace. However, if 2004 serves as a reliable benchmark, Europe should see overall acquisition activity heat up in the second half. 60% of the 30 European firms acquired in 2004 were acquired during the second half of the year.



The largest transaction involving a European target in the broker-dealer space in 1H 2005 was Credit Agricole's acquisition of Belgian-based Keytrade Bank, an online discount broker. Credit Agricole purchased 41% of Keytrade for \$132.7 million, giving the firm an implied entity value of \$323.7 million. Credit Agricole has the option to buy an additional 37% at the same price in the first half of 2007.

Institutional brokerages were in high demand in Europe in the first half of 2005. In fact, over half of the 13 European firms acquired were institutional brokerages. Four of the twelve European firms acquired during the period were based in the UK, including institutional brokerage Panmure Gordon. Panmure Gordon, formerly a division of Lazard & Co., Ltd., was purchased by Durlacher Corp, Plc for an undisclosed sum. The transaction, which closed on April 26, allows Durlacher to add significant institutional broking capabilities and clients to its current corporate finance, equity research and sales and trading platform.

Outside of the UK there was also considerable acquisition activity, once again involving institutional brokerages. Auspicious growth forecasts and continued EU expansion have substantially increased volumes on many emerging-market exchanges in Eastern and Southeastern Europe. In hopes of meeting the necessary legal requirements to qualify for EU membership, many nations in the region have significantly improved their capital market regulations, attracting sizable new capital flows in the process. EFG Eurobank Ergasias of Greece made two forays into the space in 1H 2005 acquiring Capital SA, an institutional brokerage and advisory firm based in Bucharest, and HC Istanbul, a Turkish institutional brokerage. Average daily trading volumes on the Romanian and Istanbul Exchanges have increased by 825% and 125%, respectively since 2003. Sanpaolo IMI of Italy also extended its reach into the Turkish market by acquiring 20% of institutional brokerage Global Securities, which boasts the largest domestic and international distribution network among brokerage houses in Turkey.

Summary of European Transactions (1H 2005)

Qtr.	Year	Target	Target Firm Type	Target Country	Acquirer	Acquirer Firm Type	Entity Value \$MM
2	2005	Keytrade Bank	E-Finance	Belgium	Credit Agricole SA	Commercial Bank	323.7
1	2005	Teather & Greenwood Holdings	Institutional Brokerage	UK	Landsbanki Islands	Commercial Bank	79.7
2	2005	First Securities	Institutional Brokerage	Norway	Swedbank AB	Commercial Bank	73.4
1	2005	Seydler AG	Specialist/Market Maker	Germany	Close Brothers Group Plc	Regional Investment Banl	38.0
2	2005	Resource Management Limited Group	Regional Investment Banl	UK	St. James Capital Holdings, Inc.	Private Equity	n/a
1	2005	Arnold Wills & Co. Ltd.	Retail Brokerage	UK	Jelf Group Plc	Insurance	n/a
1	2005	Panmure Gordon Investments Ltd.	Institutional Brokerage	UK	Durlacher Corp Plc	Diversified Financial Serv	n/a
2	2005	Cscreen Equity Derivatives System	Financial Technology	Sweden	Euronext NV	Exchange	n/a
2	2005	Capital SA	Institutional Brokerage	Romania	EFG Eurobank Ergasias SA	Commercial Bank	n/a
1	2005	Inwestycyjny Dom Maklerski	Institutional Brokerage	Poland	KBC Bancassurance Holdings	Institutional Brokerage	n/a
2	2005	Korean Development Bank's Hungarian Broker	Institutional Brokerage	Hungary	Budacash Brokerhaz Rt	Institutional Brokerage	n/a
2	2005	Global Securities	Institutional Brokerage	Turkey	Sanpaolo IMI SpA	Commercial Bank	n/a
1	2005	HC Istanbul Holding A.S.	Institutional Brokerage	Turkey	EFG Eurobank Ergasias SA	Commercial Bank	n/a

Source: Freeman & Co.

Note: In instances where the equity purchased was less than 100% Entity Value has been derived from the purchase price and percentage acquired

Market Data

Both the NASDAQ and NYSE, are poised to set five year highs in trading volume based on annualized 1H trading activity. Annualized first half results forecast that over \$10 billion worth of shares could be traded on the NASDAQ during full-year 2005. This would represent a 15% increase over 2004 and would mark the first time the NASDAQ trading value has exceeded the \$10 billion mark since 2001. Approximately 467 billion shares could be traded on the NASDAQ in 2005 if the first half pace continues - an increase of 2.4% over 2004 and 10.1% over 2003. The steady decline in both trading value and number of shares traded that beset the NASDAQ from 2001–2003 was reversed in 2004 and the current trend appears to be towards higher volumes and trading value.

The New York Stock Exchange has enjoyed a similar turnaround. Annualized first half results suggest that 2005 trading value on the NYSE could total upwards of \$13.7 billion, outpacing 2004's total of \$11.6 billion by 18% with as many as 400 billion shares being traded. Given that trading value and volume were nearly equal in both the first and second half of 2004 (\$5,852 billion in trading value and 186 billion shares in the first half vs \$5,756 billion in trading value and 181 billion shares in the second half) we would anticipate that actual results at year end will be in line with annualized forecasts.

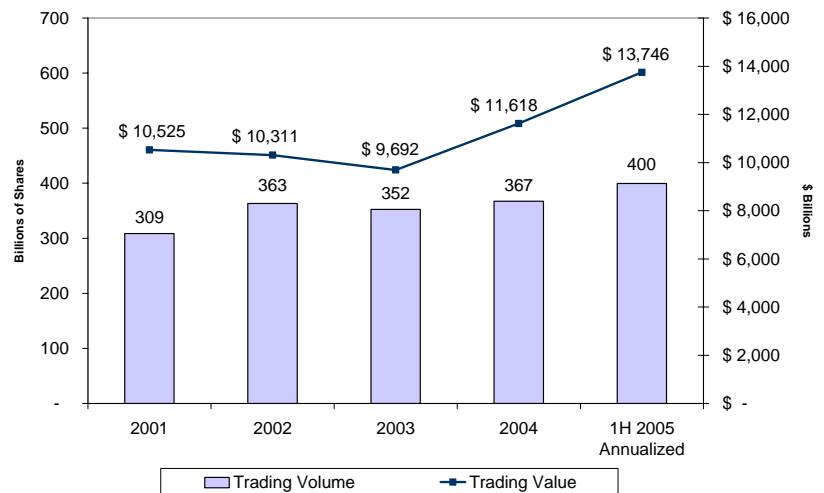
Earlier this month the S&P 500 and the Nasdaq indices hit four year highs after posting solid results in the past few months. Equity markets have benefited from increased trading activity while other securities are suffering. Credit markets have struggled with downgrades at GM and other major borrowers and returns in convertible bond trading strategies have been depleted by the huge influx of capital from hedge fund managers. Fear of a real estate bubble may have also helped drive money back into the equity markets.

If the acquisition activity in the securities industry is any indicator of Wall Street's view on equity trading volume, there may be a measured bullish attitude returning. As we have already highlighted, many of the most noteworthy deals of the first half involved trading commissions-based businesses, which would suggest a level of optimism for increased electronic trading flows or a defensive measure against future declines in traditional brokered institutional flows.

Major US Equity Indices at Year End

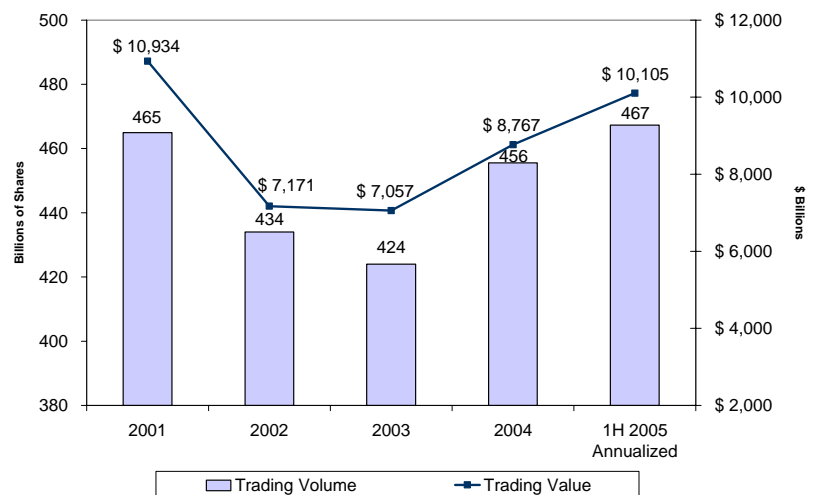
	2001	2002	2003	2004	6/30/2005
Nasdaq	1,950.4	1,335.5	2,003.4	2,175.4	2,057.0
DJIA	10,021.6	8,341.6	10,453.9	10,783.0	10,275.0
S&P 500	1,148.1	879.8	1,111.9	1,211.9	1,191.3

NYSE Trading Volume/Value



Source: www.nasdaq.com

Nasdaq Trading Volume/Value



Source: www.nyse.com

Electronic Trading & Exchange Deals

There were a host of noteworthy transactions involving exchanges in the first half of 2005, none more so than the deal between the NYSE and Archipelago. Though this deal arguably generated the most press, it was not the only deal of significance, and may have served as a catalyst for widespread activity amongst exchanges in 1H 2005. On April 22, Nasdaq Stock Market, Inc. announced that it would purchase the electronic trading business of Instinet Group, Inc. for \$934.5 million. As part of the transaction, Nasdaq also agreed to sell Instinet's Institutional Brokerage arm to private equity firm Silver Lake Partners and sell Lynch, Jones, Ryan (Instinet's Commission Recapture business) to the Bank of New York. Merrill Lynch and hedge fund heavyweight Citadel Investment Group also cast their names into the mix by paying \$75 million, respectively, for equal 10% stakes in the Philadelphia Stock Exchange, the fourth most active options exchange in the US. Philadelphia was not the only regional exchange to garner interest from potential acquirers during the period. Before being acquired itself, Archipelago agreed to purchase the Pacific Exchange in an all cash deal that includes the repurchase of some 1.6 million Archipelago shares currently held by the Pacific Exchange. The purchase price will ultimately be determined by the average closing price of Archipelago's stock for the 10 trading days leading up to the closing. Based on Archipelago's recent stock price, the Pacific Exchange is currently valued at around \$65 million. Upon completion, the deal would create the first fully electronic equities and options exchange.

The direct market access space also continued to generate attention. In addition to Nasdaq's acquisition of Instinet's Electronic Trading Network, JPMorgan announced that it would acquire Neovest Holdings, Inc.^[1] Neovest is a provider of high-performance trading technology and direct market access and offers JPMorgan a first-rate broker-neutral electronic trading platform with a significant hedge fund client base. JPMorgan, which lacked an electronic trading offering to match those offered by rivals Goldman Sachs, Morgan Stanley, CSFB and Citigroup (via Lava Trading), will market Neovest's platform to its existing institutional and hedge fund clients. The acquisition marks the continuation of a trend among large brokerage houses looking to bolster their DMA and order-routing capabilities through acquisitions. The chart above shows a number of acquisitions involving global, diversified financial institutions entering the DMA space through purchases. In 2004, Citigroup^[2], Bank of New York and Bank of America all acquired properties in the DMA space.

The increased attention large brokerages have paid to DMA providers and ECN's has stirred interest in the private equity world. Private equity buyers have entered into this space taking advantage of increased trading volumes overall and a substantiated increase in flow to straight electronic executions. For example, among the sellers of Neovest was a group of private investors led by CCP Equity Partners, a Hartford-based private equity firm. Boston-based TA Associates, which has been active in the space for a number of years including investments in Lava Trading and Island ECN, invested \$50 million in electronic derivatives platform Creditex in June of this year. TA is also the largest minority shareholder in Instinet, holding approximately 4% of the company's shares. Though historically considered a hedge fund, self described "alternative investment" firm Citadel made a sizable private-equity investment in the Philadelphia Stock Exchange as previously mentioned. While hedge funds have been making similar private equity-style investments on a regular basis lately, this transaction was particularly significant as it underscored the assumption that trading volume growth and/or consolidation is poised to continue among exchanges. Going forward, both Citadel and co-investor Merrill Lynch have the option to increase their stake in the Philadelphia Exchange, which continues to seek capital from outside investors to fund growth and technology initiatives.

Recent Direct Access Acquisitions Involving Global Financial Institutions

Year	Qtr.	Target	Acquirer
2005	2	Neovest Holdings, Inc. ^[1]	JPMorgan Chase & Co.
2005	2	Instinet Group, Inc.	Nasdaq Stock Market
2004	3	Lava Trading Inc.	Citigroup ^[2]
2004	3	Vie Securities LLC	Piper Jaffray Cos.
2004	1	Direct Access Financial Corp.	Bank of America
2004	1	Sonic Financial Technologies	Bank of New York

Select Electronic Trading & Exchanges Transactions (1H 2005)

Qtr.	Year	Target	Target Firm Type	Target Country	Acquirer	Acquirer Firm Type	Entity Value \$MM
1	2005	SunGard Data Systems, Inc.	Financial Technology	US	Consortium of Buyout Firms	Private Equity	\$ 10,400.0
2	2005	Instinet Group, Inc's Electronic Trading Network	Direct Access	US	Nasdaq Stock Market	Exchange	934.5
2	2005	Creditex, Inc	ECN	US	TA Associates	Private Equity	200.0
2	2005	Philadelphia Stock Exchange	Exchange	US	Merrill Lynch & Co.	Global Investment Bank	75.0
2	2005	Philadelphia Stock Exchange	Exchange	US	Citadel Investment Group LLC	Asset Manager	75.0
1	2005	Pacific Exchange, Inc.	Exchange	US	Archipelago Holdings, Inc.	Exchange	65.0
2	2005	Neovest Holdings, Inc. ^[1]	Direct Access	US	JPMorgan Chase & Co.	Commercial Bank	n/a
2	2005	Archipelago Holdings, Inc.	Exchange	US	New York Stock Exchange	Exchange	n/a
2	2005	Direct Trading Institutional	Financial Technology	US	Knight Trading Group, Inc	Institutional Brokerage	n/a
2	2005	ATTAIN ECN Business	ECN	US	Knight Trading Group, Inc	Institutional Brokerage	n/a

[1] Freeman & Co. Securities advised Neovest Holdings on its sale to JPMorgan

[2] Freeman & Co. Securities advised Citigroup on its acquisition of Lava Trading

Recent Freeman & Co. Publications

Broker-Dealer Focus Newsletter:

2004 Provides Foundation for Expanded Deal Volumes	January 2005
Inaugural Issue: Mid-Year Update	September 2004

Broker-Dealer Reports:

Credit: The Rite of Passage for Investment Banks?	June 2003
The End of the Line for Old Reliable: New Directions for Institutional Commission Flows	June 2002

Asset Management Focus Newsletter:

A Slow Year, Focused on Repositioning	February 2005
Alternatives Go Mainstream; Move Up the Charts	September 2004
Will Strong Returns Lead to Increases in Industry Activity?	March 2004
Struck by Scandal, but Buoyed by Bounce in Returns	October 2003
A Nadir or Not? Lowest Deal Levels in Over 6 Years	May 2003
2002 Year End Summary	January 2003

Asset Management Reports:

Are Hedge Fund M&A Deals a Sustainable Trend?	January 2005
Convergence in Alternatives	November 2004
