

LABRANCHE & CO INC
Form 10-K
March 20, 2003

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

FORM 10-K

ý **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December 31, 2002**

or
o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from _____ to _____.**

Commission file number: 001-15251

LaBRANCHE & CO INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware

(State or Other Jurisdiction of
Incorporation or Organization)

13-4064735

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

One Exchange Plaza, New York, New York 10006
(Address of Principal Executive Offices) (Zip Code)

(212) 425-1144
(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

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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.

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

The aggregate market value of the Common Stock held by non-affiliates of the registrant, based upon the last sale price of the Common Stock reported on the New York Stock Exchange on June 28, 2002, was approximately \$439,700,000.

The number of shares of Common Stock outstanding as of March 10, 2003 was 59,528,433.

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 2003 Annual Meeting of Stockholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

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 LaBranche Structured Products, LLC (LSP). LaBranche owns all of the outstanding stock of LaBranche Financial Services, Inc. (LFSI) and is the sole owner of LaBranche & Co. B.V. (BV). Founded in 1924, LaBranche & Co. LLC is one of the oldest and largest specialist firms on the New York Stock Exchange (NYSE). LaBranche & Co. LLC also acts as a specialist in equities on the American Stock Exchange (AMEX). LFSI is a registered broker-dealer and a member of the NYSE and other exchanges, and provides securities clearing, securities execution and other related services to its own retail customers, customers of introducing brokers and institutional customers, including traders, professional investors and broker-dealers. LFSI also provides direct-access floor brokerage services to institutional customers. LSP was organized in September 2002, and is a registered broker-dealer that operates as a specialist in options and a market-maker in Exchange-Traded-Funds (ETFs) on the AMEX. BV was organized in April 2002 to represent LaBranche & Co. LLC in European markets and to provide client services to LaBranche & Co. LLC's European listed companies.

We are a Delaware corporation that was incorporated in June 1999. Our principal executive offices are located at One Exchange Plaza, 25th Floor, New York, New York 10006, and our telephone number is (212) 425-1144. Our Internet address is www.labranche.com. We make available free of charge, on or through the investor relations section of our web site, annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after we electronically file such material with, or furnish it to, the Securities and Exchange Commission.

We currently view our business under two separate segments: the specialist segment and the execution and clearing segment.

Our specialist segment currently includes the operations of LaBranche & Co. LLC, LSP and BV. Our NYSE and AMEX members within the specialist segment act as the specialists for 589 common stock listings on the NYSE, 82 common stock listings and 143 options on the AMEX, and act as market-maker for approximately 40 ETFs.

Our execution and clearing segment currently includes the operations of LFSI, which provides securities execution and clearing services to retail and institutional clients and correspondents. LFSI's central focus is to bring the customer closer to the point of sale and provide price discovery at the highest speed and lowest possible cost.

Compensation and related benefits for certain employees and certain company wide professional fees are allocated to our two principal business segments. However, certain revenues and administrative and corporate overhead expenses, which consist primarily of interest on LaBranche's public debt, are not specifically allocated to our two principal business segments and thus are treated as other revenues and expenses. A description of our principal business segments is presented below.

Our Specialist Segment

The Specialist Industry

The NYSE is currently the largest securities market in the world. As of year-end 2002, the global market capitalization of all shares listed on the NYSE was approximately \$13.4 trillion and the NYSE had nearly 2,800 listed companies, including approximately 470 non-U.S. companies from 51 countries.

The NYSE's average daily trading volume for 2002 was 1.4 billion shares, up from 1.2 billion shares in 2001.

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 substantially over the past several years due to consolidation within the industry. There are currently seven NYSE specialist firms, of which the three largest, as ranked by number of specialist stocks, were responsible for approximately 69.0% and 69.6% of the average daily share volume in 2002 and 2001, respectively.

A specialist firm is granted an exclusive 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.

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:

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;

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;

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

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 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 firm. In addition, the specialist firm's trading practices are subject to a number of restrictions, as described in NYSE and AMEX Rules Governing Our Specialist Activities.

Recent Trends in NYSE Trading

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 as a result of many factors, including:

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

an increase in NYSE listings of non-U.S. companies;

transfers from Nasdaq;

spin-offs;

trading in decimal price increments.

Despite the increases in NYSE share volume, the difficult global market and economic conditions that existed during 2001 continued throughout 2002, adversely affecting our specialist operations. Although 2002 began with expectations of improved economic performance, weak corporate earnings, increased uncertainty about the strength and pace of the global economic recovery and continued revelation of numerous corporate accounting and governance irregularities undermined investor confidence. As a result, the equity markets in which we operate experienced sharp declines during 2002. Uncertainty surrounding continuing terrorist threats and increased geopolitical tensions also have contributed to investor lack of confidence and reluctance to participate in the equity markets.

In January 2001, the NYSE commenced trading in decimals. To date, studies on the effects of decimalization on NYSE trading have shown that bid-asked spreads and quote sizes have decreased, and the percentage of shares receiving price improvement has increased. Despite the documentation of these findings, it has been difficult to determine the precise effect of decimalization on our principal trading revenue, and we do not know the effect decimalization will have on our principal trading revenue in the future.

The majority of trades in NYSE-listed stocks take place through NYSE specialist firms. In 2002, specialist firms handled approximately 81.9% of trades in NYSE-listed stocks as compared to 84.0% in 2001. Trades in NYSE-listed stocks also are generally effected as follows:

some stocks are listed on multiple exchanges, such as regional exchanges, and trades take place on those exchanges; and

NYSE-listed stocks may be traded off the NYSE in the over-the-counter market.

Technological advances have contributed to increased trading through alternative trading systems, called ATs, 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 several 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 ATNs will forward unfilled orders to other ATNs or to exchanges such as the NYSE. Some of these networks also allow limited negotiation between members to facilitate a match. These ATNs generally limit trades over their systems to their members, who are typically large financial institutions, professional traders or brokerage firms. Additionally, some ATNs 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.

Despite the presence of these ATNs, thus far, there has been an insignificant decline in the volume of equities traded on the NYSE as opposed to these alternative systems. The percentage of annual trading of NYSE-listed stocks on the NYSE has ranged from 81.9% to 84.0% for the past five years. The decline in NYSE's share of consolidated tape volume from 84.0% in 2001 to 81.9% in 2002 was primarily due to the increase in NYSE stocks trading below \$5 as a result of the continuing bear market. It is unclear, however, how the alternative trading methods and new technologies just described or that may be developed will affect the future percentage of trading in listed stocks conducted on the NYSE.

In response to the advent of these ATNs, the NYSE has launched Network NYSE, a suite of market information and auto-execution products offering new choices to different types of customers. Some examples of these new products include:

NYSE Direct+[®], an automatic execution service for limit orders up to 1,099 shares, enabling investors to automatically execute orders at the national best bid offer;

NYSE OpenBook(SM), an online market data product allowing subscribers to view information on the NYSE limit order books; and

Institutional Express(SM), an electronic gateway to satisfy large order requirements, including the growing information needs of NYSE member firms and their institutional customers.

We believe these recent NYSE product developments will further benefit our specialist business by offering investors new choices within the NYSE auction market system. These choices should enable both retail and institutional investors to access the world's largest pool of liquidity, and execute their trades through NYSE specialists—the focal point of the NYSE's auction-based system.

Our Specialist Operations

Our NYSE and AMEX Equity Specialists

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Our NYSE and AMEX equity specialist operations are conducted through our LaBranche & Co. LLC subsidiary. As a specialist in equities on the NYSE and AMEX, its role is to maintain, as far as practicable, a fair and orderly market in its specialist stocks. In doing so, it provides a service

to its listed companies, and to the brokers, traders and investors who trade in its 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 specialist business has grown considerably over the past several years. Our revenues from our specialist operations have increased from approximately \$95.0 million in 1998 to \$340.8 million in 2002. We have accomplished our growth both internally and through acquisitions. Since the NYSE implemented its new specialist allocation process in March 1997, we have been selected by 124 new listed companies, resulting from 261 listing interviews through December 31, 2002. In addition, we have acquired eleven specialist operations since 1997, adding approximately 500 NYSE common stocks and 52 AMEX common stocks. As a result of internal growth and selective acquisitions, our LaBranche & Co. LLC subsidiary currently is one of the leading NYSE specialists as illustrated by the following data:

the annual dollar volume on the NYSE of stocks for which LaBranche & Co. LLC acted as specialist was \$2.7 trillion, or 27.2% of total NYSE dollar volume in 2002, and \$2.5 trillion, or 27.6% of total NYSE dollar volume in 2001. By this measure, LaBranche & Co. LLC was the largest NYSE specialist firm in 2002;

the annual share volume on the NYSE of stocks for which LaBranche & Co. LLC acted as specialist was 102.0 billion, or 28.7% of total NYSE share volume in 2002, and 76.0 billion, or 28.5% of total NYSE share volume in 2001. By this measure, LaBranche & Co. LLC was the largest NYSE specialist firm in 2002; and,

the total number of LaBranche & Co. LLC's common stock listings was 589, or 22.8% of all NYSE common stock listings as of December 31, 2002, and 591, or 22.9% of all NYSE common stock listings as of December 31, 2001. By this measure, LaBranche & Co. LLC was the largest NYSE specialist firm as of December 31, 2002. In addition, LaBranche & Co. LLC acted as the specialist for 272 other NYSE-listed securities (e.g., preferred and convertible securities).

As of December 31, 2002, our listed companies included:

101 of the S&P 500 Index companies; and

nine of the 30 companies comprising the Dow Jones Industrial Average. Our Dow stocks are 3M Co., Altria Group, Inc., American Express Company, AT&T, DuPont, Eastman Kodak, ExxonMobil, Merck, and SBC Communications.

Our AMEX Options Specialist

Our NYSE and AMEX Equity Specialists

We originally entered into the AMEX options specialist business through our LaBranche & Co. LLC subsidiary upon the acquisition in December 2000, of 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 & Cranmer, Inc., a firm which acted as the specialist for both equities and options on the AMEX. Through September 25, 2002 our AMEX

specialist operations for both equities and options were conducted entirely by LaBranche & Co. LLC. Since September 25, 2002, we have conducted our AMEX options specialist business activities through LSP, our newly-organized wholly-owned subsidiary. Our specialist activities related to equities on the AMEX remained at LaBranche & Co. LLC. In addition to acting as the specialist for 143 AMEX-listed options, LSP acts as a market-maker in approximately 40 ETFs.

As a specialist in options on the AMEX, LSP is responsible for creating a fair and orderly market in the trading of its specialist options. In doing so, LSP may at times be obligated to trade against the market, adversely impacting the profitability of the trade or creating a position that may not necessarily be desired. To hedge the risk of its option positions, LSP may buy or sell the stock underlying the option.

As a market-maker in approximately 40 ETFs, LSP is not obligated to create a fair and orderly market. Thus, it can willingly buy and sell the ETFs for which it acts as a market-maker, but it is not obligated to do so. LSP hedges its ETF positions with a combination of financial futures, baskets of underlying stocks and other ETFs.

Our Specialist Support Services

In April 2002, BV was organized to represent our specialist segment in European markets and to provide client services to our specialist segment's European listed companies. BV was established under Dutch law, and its office is in Amsterdam. The entity, through a services agreement, provides monitoring and trading services for LaBranche & Co. LLC's specialist stock positions on an overnight basis, as specifically directed by appropriately designated LaBranche & Co. LLC personnel. In addition, BV markets the services of our specialist entities to existing and prospective European companies.

NYSE and AMEX Rules Governing Our Specialist Activities

Under NYSE and AMEX 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 its specialist stocks. The specialist is not expected to act as a barrier in a rising market or a support in a falling market, but must use its own judgment to try to keep such price increases and declines equitable and consistent with market conditions.

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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 maintenance of price continuity with reasonable depth.

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:

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;

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;

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;

The specialist does not charge commissions for trades in which it acts as a principal;

Except in some circumstances in less active markets, the specialist may not, without permission from an exchange official, initiate destabilizing trades for its own account which cause the stock price to rise or fall; and

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.

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 with, receive payments or loans from, or engage in certain business transactions with any of its listed companies.

Listed Company Services

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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 20 full-time employees devoted to serving our listed companies. The most important function of the Corporate Relations Department is to provide current market information to the listed companies.

In addition, we help to educate our listed companies on general market trends. We organize annual educational conferences that review trends in the securities industry and equity markets. We also survey our specialist companies annually on the quality of our services, and use the information obtained in these surveys to continually improve our services. For newly listed companies on the NYSE, we provide additional investor relations support services to assist the companies with their transition to the NYSE. These services, which are often outsourced, add significant value for companies considering a listing on the NYSE.

Competition in the Specialist Industry

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

the strength of our capital base;

our willingness to commit our own capital and trade for our own account while conducting our specialist operations; and

the ancillary services we offer our specialist companies, such as providing information on the trading activities in their stocks.

The specialist industry experienced a vast and accelerated consolidation over the past several years. In 2002, the three largest specialist units as ranked by their number of specialist stock listings accounted for 69.0% of the daily share volume traded on the NYSE. As a result of the consolidation, the competition for obtaining new listed companies is intense. We expect competition to continue and intensify in the future as some of our competitors may have greater financial resources and product service offerings.

Our Specialist Segment'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:

Leading Position in the Specialist Market. We have a long-standing reputation as one of the leading specialist firms on the NYSE and have established and are expanding our presence on the AMEX. 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 2002 accounted for 27.2% of the dollar volume on the NYSE and 28.7% of the share volume. By these measures, we were the largest specialist firm on the NYSE. As of December 31, 2002, we acted as specialist for 589 common stocks listed on the NYSE and 82 listed on the AMEX. Of our NYSE common stock listings, 134 and 123 were non-U.S. listings as of December 31, 2002 and December 31, 2001, respectively.

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. They range in market capitalization from some of the smallest on the NYSE and AMEX to some of their largest and most well-known. 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 2002, approximately 32.4% of our trades were as principal as compared to an average of approximately 30.2% 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 information 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 provide customized support services for our listed companies to assist in their investor relations efforts.

Completed Acquisitions. Since 1997, we have acquired eleven specialist operations adding approximately 500 NYSE common stocks and 52 AMEX common stocks, solidifying our position as one of the leading NYSE specialist firms, as well as establishing and expanding our presence on the AMEX.

Our Execution and Clearing Segment

Recent Trends in Execution and Clearing Industry

During the last few years, the traditional, clearing industry has experienced a major consolidation, resulting in a small number of highly capitalized and extremely focused competitors. Utilizing enormous scale, the top few competitors in the business have captured the majority of the correspondent clearing market while providing retail sales organizations with a cost effective and dependable operations platform. This business is highly specialized, requires significant balance sheet resources and has become dominated by large commercial and investment banks.

As electronic delivery methods and clearing procedures proliferate, the cost of providing executions has dropped and there has been an accompanying drop in the general level of commissions. The contraction in financing activity and flow of money to mutual fund managers has pressured both the buy and sell sides severely. With the resumption of economic growth and the return of financing activity, we believe that industry capacity should be more fully utilized and commissions should stabilize.

Our Execution and Clearing Operations

Our execution and clearing segment provides securities clearing, trade execution and other related services to its own retail customers, customers of introducing brokers and institutional customers, including traders, professional investors and other broker-dealers. We also provide direct access floor brokerage services to institutional customers and provide front-end order execution to a range of clients.

Unlike traditional clearing firms, LFSI is not focused on the commoditized, bulk clearance, custody and execution business. Rather, it targets specialized lines of business where flexibility, technological expertise and a highly versatile execution and clearance platform provides us with a competitive advantage. LFSI's central focus is to bring the customer closer to the point of sale and provide price discovery at the highest speed and lowest possible cost.

In July 2002, we formed the Institutional Execution Group (IEG), which specializes in providing institutions with personalized service by reacting to their execution needs. IEG's primary focus is to provide institutional customers with timely executions at the best price with minimal market impact. IEG offers the ability to both execute and clear trades on the NYSE, AMEX and Nasdaq/OTC with seamless straight-through processing from order origination to trade execution. Customers of IEG can also utilize its web-based technology in order to preserve anonymous representation of their orders on the NYSE trading floor and other venues.

Regulatory Matters

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, the NYSE, AMEX and other regulatory organizations 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.

Our broker-dealer subsidiaries, LaBranche & Co. LLC, LFSI and LSP, are subject to regulations concerning operational and financial aspects of their respective businesses. They are subject to registration requirements with various government entities and self-regulatory organizations, commonly referred to as SROs, with which they must comply before they can conduct business. They are also subject to laws, rules and regulations requiring them to comply with financial reporting rules, trade practices, capital structure obligations, and record retention requirements. Failure by any of our broker-dealer subsidiaries 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 its directors, officers or employees, and other negative consequences, which could have an adverse effect on our businesses. From time to time, in the ordinary course of business, we have been subject to immaterial fines for violations of such laws, rules or regulations.

As a NYSE specialist firm, LaBranche & Co. LLC is under constant review by the NYSE on all aspects of its 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

Our broker-dealer subsidiaries, LaBranche & Co. LLC, LFSI and LSP, are also subject to net capital requirements as required by SEC Rule 15c3-1, and net liquid asset requirements as required by the NYSE and AMEX. Please see the Liquidity section of our Management's Discussion and Analysis of Financial Condition and Results of Operations for our subsidiaries' capital requirements and actual amounts.

Failure to maintain the required net capital and/or net liquid assets may subject our broker-dealers to suspension or revocation of SEC registration or suspension or expulsion by the appropriate exchanges.

Employees

As of December 31, 2002, we had 595 full-time employees, including 65 managing directors. As of February 28, 2003, we had 597 full time employees, including 67 managing directors, of which 437 were employed at our specialist segment, 123 were employed at our execution and clearing segment, and 37 were employed at LaBranche. Of the total 597 full time employees, 110 were NYSE specialists, 14 were AMEX specialists, 256 were trading assistants, and the remaining 217 employees worked in clearing operations, corporate relations, registered representatives, management, administration, finance and other departments.

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.

Item 2.

PROPERTIES.

Our offices are located at One Exchange Plaza, New York, New York, where we lease approximately 36,000 square feet under two separate leases expiring in January 2008, and at 120 Broadway, where we lease approximately 45,000 square feet under a sublease expiring in March 2006. In addition, we also leased approximately 9,000 square feet at One Exchange Plaza under a lease, which expired in January 2003. We also lease five trading posts on the floor of the NYSE, approximately 24,000 square feet of additional space at locations in New York and New Jersey under leases expiring between August 2003 and September 2012 and approximately 1,100 square feet in Amsterdam, Netherlands, under a lease expiring in April 2004. 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 near future.

Item 3.

LEGAL PROCEEDINGS.

The Company and, in particular, certain of the business operations conducted by LFSI's predecessor in interest, ROBB PECK McCOOEY Clearing Corporation, have been the target, from time to time, of various claims and lawsuits incidental to the ordinary course of their

respective businesses. While the ultimate outcome of those claims and lawsuits which currently are pending cannot be predicted with certainty, we believe, based on our understanding of the facts of these proceedings, that their ultimate resolution will not, in the aggregate, have a material adverse effect on our financial condition or results of operations.

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, 2002.

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 our common stock on the NYSE for the periods indicated:

| | High | Low |
|---------------------------|----------|----------|
| <u>Fiscal 2001</u> | | |
| First Quarter | \$ 51.03 | \$ 27.69 |
| Second Quarter | 44.52 | 28.56 |
| Third Quarter | 30.22 | 19.50 |
| Fourth Quarter | 35.11 | 22.12 |
| <u>Fiscal 2002</u> | | |

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| | | |
|----------------|-------|-------|
| First Quarter | 36.11 | 29.88 |
| Second Quarter | 30.93 | 21.90 |
| Third Quarter | 23.50 | 17.50 |