KNIGHT TRADING GROUP INC
Form 10-K
March 29, 2001

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

[X] ANNUAL REPORT PURSUANT TO SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2000

OR

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

001-14223
Commission File Number

KNIGHT TRADING GROUP, INC.
(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of incorporation or organization)

22-3689303
(I.R.S. Employer Identification Number)

525 Washington Boulevard, Jersey City, NJ 07310
(Address of principal executive offices and zip code)

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

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

Securities registered pursuant to Section 12(g) of the Act:
Shares of Class A Common Stock, $0.01 par value

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

Indicate by check mark 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. [_]

The aggregate market value of the Class A Common Stock held by nonaffiliates of the Registrant was approximately $ at March 28, 2001 based upon the closing price for shares of the Registrant's Class A Common Stock as reported by the National Market System of the Nasdaq Stock Market on that date. For purposes of this calculation, affiliates are considered to be officers, directors and holders of 10% or more of the outstanding common stock of the Registrant.

At March 28, 2001 the number of shares outstanding of the Registrant's Class A Common Stock was 123,650,480 and there were no shares outstanding of the Registrant's Class B Common Stock as of such date.

DOCUMENTS INCORPORATED BY REFERENCE

Definitive Proxy Statement relating to the Company's 2001 Annual Meeting to be filed hereafter (incorporated into Part III hereof).

KNIGHT TRADING GROUP, INC.
FORM 10-K ANNUAL REPORT
For the Fiscal Year Ended December 31, 2000

TABLE OF CONTENTS

UNLESS OTHERWISE INDICATED, REFERENCES TO THE "COMPANY" MEAN KNIGHT TRADING GROUP, INC. AND ITS SUBSIDIARIES.

Except for historical information contained herein, the matters discussed in this report contain certain forward-looking statements that involve risks and uncertainties that could cause actual results to differ materially from those anticipated in such forward looking statements. Factors that may cause such differences include, but are not limited to: the effect of client trading patterns on Company revenues and earnings; computer system failures; the effects of competitors' pricing, product and service decisions and intensified competition; evolving regulation and changing industry customs and practices adversely affecting the Company; adverse results of litigation; changes in revenues and profit margin due to cyclical securities markets and interest rates; and a significant downturn in the securities markets over a short period of time or a sustained decline in securities prices and trading volumes.

PART I

Item 1. Business

Overview

We are a leading wholesale market maker. Market makers hold themselves out to execute trades by offering to buy or sell securities for their own account. We have attained our leadership position by providing best execution services to broker-dealer and institutional clients through our proprietary trading methodology and sophisticated trading systems.

Through our subsidiaries, we make markets in global equities and global derivatives, and we operate an asset management business. Our subsidiary, Knight Securities, L.P. ("KS"), is the leading market maker in Nasdaq securities. Knight Capital Markets LLC ("KCM") holds the leading market position in the Nasdaq Inter-Market, the over-the-counter market in exchange-listed equity securities, primarily those listed on the New York Stock Exchange ("NYSE") and the American Stock Exchange ("AMEX"). Knight Financial Products LLC ("KFP") is a leading market maker in listed options on individual equities, equity indices and fixed income futures instruments in the U.S. and Europe. We also maintain an asset management business for institutional investors and high net worth individuals through our Deephaven Capital Management subsidiary.

In 1993, in the midst of significant changes in the securities industry, our founders developed a vision of the next-generation business model for market making. The business model required a focus on client service, state-of-the-art technology and operating efficiencies resulting from high trading volumes. In 1995, our founders' vision materialized with the acquisition of Trimark Securities, Inc. (subsequently renamed KCM) and the establishment of KS. Through KS, we make markets in approximately 9,100 equity securities in Nasdaq and on the OTC Bulletin Board of the National Association of Securities Dealers, Inc. ("NASD"). Through KCM, we make markets in the Nasdaq Inter-Market.

Since our inception in 1995, we have experienced significant growth in market share. Our dedication to providing quality executions allowed us to quickly expand our broker-dealer and institutional client base during the rapid increase of on-line investing that occurred over the past five years. We have maintained a strong market share in the markets in which we participate as follows:

- Based on data from The AutEx Group, a widely recognized industry reporting service that publishes daily trading volume and market share statistics reported by broker-dealer market makers, KS achieved a #1 market share ranking of volume in Nasdaq in February 1998. KS has continued to maintain this #1 ranking, despite the decline of the Nasdaq market since March 2000. The volume of Nasdaq shares traded by KS increased from 1.4 billion shares in the month of January 1998 to 6.4 billion shares in the month of December 2000. However, our volumes have declined during the first quarter of 2001 as retail trading levels have fallen from 2000.

- According to the NASD, KCM has held the #1 market share ranking in the trading of the over-the-counter market for NYSE-listed securities in the Nasdaq Inter-Market for over two years. KCM's trading volume of the over-the-counter market for NYSE-listed securities has increased from 342.9 million shares in January 1998 to 1.0 billion shares in December 2000. During the same period, KCM's market share increased from

3

2 9.5% to 44.4%. However, KCM's volumes and market share have declined during the first quarter of 2001 as retail trading levels have fallen from 2000.

- According to the NASD, KCM has also held the #1 market share ranking in the trading of the over-the-counter market for AMEX-listed securities in the Nasdaq Inter-Market for over two years. KCM's trading volume of the over-the-counter market for AMEX-listed securities has increased from 59.4 million shares in January 1998 to 199.7 million shares in December 2000. During the same period, KCM decreased its market share from 64.8% to 47.2%. KCM's volumes and market share have declined during the first quarter of 2001 as retail trading levels have fallen from 2000.

- KFP's trading volume in listed options grew by over 300% in 2000, consistent with the growth in the overall options market. KFP's trading volume increased to 21.4 million option contracts in 2000 from 5.6 million option contracts in 1998. In 2000, KFP began specialist operations on the Philadelphia Stock Exchange and the Pacific Stock Exchange. Additionally, KFP became a founding participant on the newly launched International Securities Exchange. KFP also purchased the professional execution services business from Mesirow Financial, which was subsequently renamed Knight Execution Partners ("KEP").

For the year ended December 31, 2000, we had revenues of $1,257 million, a 40% increase from 1999 revenues of $897 million. Our pro forma pre-tax income grew to $418 million in 2000, a 33% increase over 1999 pre-tax income of $315 million. Additionally, in 2000, our return on equity was 38%, and our pre-tax margins were 33%. In 2000, we executed 142.7 million trades and traded 112.1 billion shares, up from 90.7 million trades and 81.0 billion shares in the prior year.

International Expansion

In March 2001, we finalized our first closing for a pan-European market making venture with 19 broker-dealers and banks from Europe and the United States. Our partners in the initial closing of Knight Roundtable Europe Limited, which consist of a diverse group of leading pan-European and U.S. securities firms, banks and broker-dealers, have contributed a total of $27.6

million. This amount has been matched by us and we have also contributed to the venture our UK broker-dealer, Knight Securities International, Ltd. ("KSIL"). Following this closing, our ownership in Knight Roundtable Europe Limited stands at approximately 85%. Additional closings are anticipated, and, upon completion, our partners could collectively own up to 30% of the venture. We believe Knight Roundtable Europe Limited will further establish our international presence by leveraging technology and the Company's trading methodologies to provide best execution solutions for European investors in pan-European and U.S. equities.

In the third quarter of 2000 we established a joint venture operation with Nikko Securities Co., Ltd. to provide wholesale market-making services in Japanese equity securities. The new entity, called Knight Securities Japan Ltd. ("KSJ"), is registered as a securities firm in accordance with Japanese Securities and Exchange Law. We own 60% of this joint venture. KSJ began trading Jasdaq equity securities in December 2000. Ultimately, the new operation expects to expand its market-making services to stocks traded on additional Japanese equity markets. We also expect to form a consortium of securities firms, broker-dealers and banks.

Merger with Arbitrade Holdings LLC

On November 17, 1999, we entered into an Agreement and Plan of Merger with Arbitrade Holdings LLC ("Arbitrade"), an options market maker and asset manager with operations in the U.S. and Europe, and its members. On January 12, 2000, we completed our acquisition of Arbitrade and subsequently renamed its options market-making subsidiary, KFP. The Arbitrade transaction, which was accounted for as a pooling of interests, resulted in a newly formed parent holding company that issued shares on a tax-free basis to holders of our Class A Common Stock and to the owners of Arbitrade. Following the transaction, the Company and Arbitrade became subsidiaries of the new parent holding company, which assumed the name "Knight Trading Group, Inc." and became the publicly traded Nasdaq company under the same ticker symbol-NITE. This reorganization resulted in the automatic exchange of shares of our Class A Common Stock for shares of Class A Common Stock of the new parent holding company, on a one-for-one basis.

4

Upon completion of the Arbitrade transaction, Arbitrade members received 10,505,001 shares of newly-issued Class A Common Stock of the new parent holding company. Such shares of Class A Common Stock represented approximately 8.6% of the outstanding stock of the new parent at that time. The number of shares received by the Arbitrade members was calculated based on an exchange ratio which was determined through arms-length negotiation. The foregoing summary is qualified in its entirety by reference to the Merger Agreement, a copy of which was filed as an exhibit to the Company's Form 8-K filed with the SEC on January 12, 2000.

Industry Background

During recent years, the U.S. market for equity securities has experienced dramatic growth in trading volumes. The average daily volume of securities traded in Nasdaq increased from 225.0 million shares in December 1992 to 2.2 billion shares in December 2000. The average daily volume of securities traded on the NYSE increased from 222.2 million shares in December 1992 to 1.2 billion shares in December 2000. During this period, the average daily trading volume in the OTC market for exchange-listed securities has also increased significantly. The increase in trading volume has resulted from a number of factors, including:

. increased cash flows into equity-based mutual funds;

. historic high returns in U.S. equity markets;

. the emergence and rapid growth of on-line discount brokers;

. technological innovations, like the emergence of the Internet; and

. reduced transaction costs

The retail brokerage business has been impacted by advances in technology that have provided new and inexpensive means for individual investors to access and participate in the market for equity securities. For example, the Internet has facilitated individual investors' access to market information and has significantly reduced transaction costs. The proliferation of Internet brokers has resulted in dramatically lowered commissions charged for trading securities. While handling an increasing number of trades for a wide range of securities, Internet brokers also provide more immediate access to the marketplace than many other retail brokers. Additionally, mutual funds and other institutional investors are also demanding better execution of their trades and are seeking to reduce trading costs. The Internet brokerage business model and the demands of institutional investors have forced traditional brokers to change their approach to their business and seek ways to manage increased trading volumes while providing improved trade execution and reducing costs.

Market makers provide trade executions by offering to buy securities from, or sell securities to, broker-dealers and institutional investors. Market-making firms that have elected to make a market in a security display the price at which they are willing to bid, meaning buy, or ask, meaning sell, these securities and adjust their bid and ask prices in response to the forces of supply and demand for each security. Market makers are either a department within larger, diversified securities firms or independent businesses. The internal market-making departments of securities firms often are limited in their ability to handle significant trading volumes in a broad range of securities. Most discount brokers and on-line brokers do not have internal market-making functions and, accordingly, rely entirely on third party market makers for trade execution.

A market maker typically acts as principal and derives most of its revenues from the difference between the price paid when a security is bought and the price received when that security is sold. In the past, market makers relied on the spreads between bid and ask prices to ensure profitability and built cost structures based on these spreads. However, changes in regulations governing the securities industry and, to a lesser extent, the quoting of sixteenths rather than eighths of a dollar, have dramatically reduced average spreads. Implemented in January 1997, the SEC's Limit Order Display Rule requires the display or execution of client orders to buy or sell stock at a particular price, commonly referred to as limit orders, that (1) are priced better than a market maker's quote or (2) in certain circumstances add to the size associated with the market maker's quote when the market maker is at the best price in the market. The Limit Order Display Rule enables investors to advertise directly their trading interest to the market, allowing them to compete with market maker quotes and affect the size of bid-ask spreads.

Additional regulations adopted by the NASD require market makers to fill a client's limit order before their own trades. Since the implementation of the Limit Order Display Rule and the move to trading in sixteenths of a dollar, Nasdaq and NYSE spreads have each significantly decreased. We expect spreads to decline further with the introduction of decimal trading on Nasdaq and the various exchanges. Trading in decimal prices commenced in NYSE and AMEX listed securities in January 2001, and based on initiatives taken by the SEC, we anticipate that decimal pricing will commence in Nasdaq markets in April 2001. This date is subject to possible delay due to technological constraints.

In this new narrower spread environment, maintaining profitability has become extremely difficult for many traditional market makers. At the same time, market makers have become subject to an increasing demand for better execution standards and improved customer service. To meet these demands and remain competitive, market makers have been forced to reexamine their traditional spread-based approach to market-making and to make extensive technological and human resource investments. To leverage these large investments and to remain profitable, market makers must execute a larger volume of trades and maintain increased inventory positions. However, the significant increases in trading volumes are only a benefit for the market maker if its cost per trade is lower than its revenues per trade and if the market maker is able to manage the risks associated with larger inventory positions.

While large volumes of trading provide an opportunity to spread fixed costs over a larger number of trades, net profit per trade in the industry has significantly declined. In addition, significant volatility in equity markets, particularly in Internet and technology stocks, has led to significant fluctuations in the profitability in trading such stocks for market makers. In response to tightening spreads and increasing volatility in the equity markets, market makers need to seek new trading methodologies to identify and take advantage of the profit opportunities represented by each trade. These market makers also need to increase the number of buy and sell orders that they receive, commonly referred to as order flow. This increased order flow will, in turn, provide increased trading profit opportunities. These market makers require efficient and sophisticated systems and risk management practices and personnel with the requisite expertise to deliver superior trade execution and client service, while handling increased order flow and maintaining low cost per trade.

The Knight Trading Group Solution

We are committed to providing a superior execution methodology that emphasizes automated execution and rule compliance, real-time information access to clients and pricing plus liquidity advantages based upon our willingness to commit capital. While most of our trades are automatically executed electronically, automatic execution is highly dependent on the determination and manual entry of bid-ask prices by traders. Furthermore, our trading revenues depend significantly on the management of inventory by our skilled and experienced trading professionals. The main elements of our solution include:

. Superior Execution and Enhanced Liquidity. We have implemented a variety of best execution practices that provide our clients with significantly enhanced liquidity. These practices include the following, but do not address a decimalized environment. In such case, these practices may change:

KS

--KS guarantees to provide automated, electronic executions at the unlocked, uncrossed National Best Bid or Offer (NBBO) or better in approximately 3,400 Nasdaq issues in which it makes markets for market and marketable limit orders (exclusive of short sales) up to 2,000 shares, regardless of quote size.

--KS guarantees to price improve retail market and marketable limit orders (exclusive of short sales) representing the first 250,000 shares received before 9:25 a.m. (ET) in all Nasdaq issues for which KS makes markets at a fixed rate of 1/64 per share where the first unlocked, uncrossed NBBO has a spread greater than 1/32, regardless of order imbalances.

--KS guarantees to execute market and marketable limit orders (exclusive of short sales) representing the first 250,000 shares received no later than ten (10) minutes before the commencement of trading at the mid-point price of the first unlocked, uncrossed NBBO in all Nasdaq new issues (IPOs) for which KS intends to make markets, regardless of order imbalances.

6

--KS guarantees to provide automated price improvement of 1/16th of a point to retail market orders, between 100 and 499 shares inclusive, for Nasdaq stocks in the S&P 500, when the unlocked, uncrossed NBBO spread is equal to or greater than 1/8th of a point.

KCM

--KCM provides execution services in every NYSE- and AMEX-listed equity security.

--KCM accepts all orders that can be sent to a primary exchange, i.e., short sales, all or none, stop orders, etc.

--KCM offers liquidity enhancement for market orders in most listed S&P 500 stocks at the NBBO regardless of the quote's size.

--KCM not only guarantees the client's market order to receive the best price available on any exchange or by any competing market maker, but also frequently delivers that price for many more shares than advertised.

--KCM offers various services such as limit order protection (based on the primary exchange price) and price improvement guarantees.

All of the Company's guaranteed and automated execution protocols are predicated upon the existence of normal market conditions. We reserve the right at our sole discretion to reduce, modify, suspend, or cancel any of our automated order handling protocols, including automated price improvement and automatic execution, without prior notice on a stock by stock or client by client basis, when periods of extreme or unusual market conditions exist, risk management protocols so dictate, attempts are made to circumvent our automated executions size limitations, or we otherwise deem it appropriate. Our net trading revenue, which represents trading gains net of trading losses, is primarily affected by changes in equity trade and share volumes and option contract volume, our ability to derive trading gains by taking proprietary positions, changes in execution standards, volatility in the marketplace and by regulatory changes and evolving industry customs and practices.

- Sophisticated Trading Technology. We rely on sophisticated technology to facilitate our market-making activities. KS, KSIL and KSJ use the BRASS(R) trading system under license from SunGard Trading Systems (formerly known as Automated Securities Clearance). BRASS(R) is used by over 260 market makers. KS is one of a small number of BRASS(R) users to run BRASS(R) on its own computers with its own personnel, while other market makers, and our KSIL and KSJ subsidiaries, use SunGard Trading Systems as a service bureau. KCM employs a TCAM/Appletree trading system. KFP has developed its own proprietary trading system. We have made significant investments in our technology platform and infrastructure since our inception. All of our trading systems are augmented by software applications that enable the processing of a large volume of order flow efficiently, without diminishing speed of execution. Our equity market-making systems are designed to process up to 1.5 million trades per day. This capacity assumes an even distribution of trading activity throughout the day; however, our systems may experience processing delays during peak volume periods that result from heavy trading activity. In the fourth quarter of 2000 we handled an average of 539,000 trades per day and on April 4, 2000 we set our daily equity trade record by executing 1,049,000 equity trades. We continue to invest in technology to enhance further our processing capability.

- Superior Trading Methods. Our net trading revenues are dependent on our ability to evaluate and act rapidly on market trends and to manage risk successfully. Our methodology focuses on the dynamic, real-time analysis of market activity and price movements, which enables us to manage risk better. Throughout the business day, we continually analyze our trading positions in individual securities and monitor our short and long positions and our aggregate profits and losses. Management uses this information to assess market trends and adjust its trading strategy on a real-time basis in an effort to maximize its trading profits.

- Commitment to Highest Quality Client Service. We are committed to providing the highest quality client service. We believe that our highly skilled, experienced and entrepreneurial workforce can effectively address the needs of our clients. We have over 120 experienced employees involved in client service. Our client service group is dedicated to handling orders greater than the automated execution size and ensuring consistent quality of execution.

7

Throughout 2000 and 1999, KS maintained its #1 market share ranking as published by The AutEx Group. KS's share volumes, as compiled by us, and our market share, compiled from data reported by the NASD, are as follows:

Month Ended	Nasdaq Share Volume (per the Company)*	Percentage of the market (per the NASD)	NASD OTC Bulletin Board and Other OTC Share Volume (per the Company)	Percentage of the market (per the NASD)
	(in thousands)		(in thousands)	
2000				
December...	4,381,802	7.29%	2,849,764	25.43%
November...	3,669,478	7.11	2,192,909	25.39
October....	4,096,220	6.95	2,107,123	24.36
September..	3,623,396	7.85	2,197,756	25.38
August.....	3,678,047	8.41	2,367,929	26.49
July.......	3,397,534	8.28	1,703,357	24.96
June.......	3,695,814	8.48	1,851,812	23.17
May........	3,287,882	8.20	1,668,242	20.48
April......	3,867,611	8.49	2,352,712	20.78
March......	6,123,099	9.44	6,575,857	18.00
February...	4,866,435	10.71	8,560,755	27.86
January....	4,260,922	9.85	7,466,560	29.58

1999				
December...	4,491,100	11.30%	4,150,515	27.33%
November...	4,002,437	11.00	3,639,610	29.06
October....	2,680,756	9.26	1,842,901	24.23
September..	2,646,433	9.82	1,601,810	23.97
August.....	2,496,024	9.78	2,148,911	24.82
July.......	2,738,455	10.46	2,334,654	25.87
June.......	2,326,839	9.34	2,752,638	26.68
May........	2,323,029	9.99	3,267,537	27.07
April......	2,981,933	10.16	3,485,738	24.69
March......	2,466,752	9.36	1,791,757	23.84
February...	2,041,634	9.39	1,934,942	26.67
January....	2,432,428	9.62	1,425,306	23.50

* includes Nasdaq National Market and Nasdaq Small Cap Market

KCM's market share is based on statistics provided by the NASD.

	Nasdaq Inter-Market Volume in					
	NYSE-listed Securities			AMEX-listed Securities		
Month Ended	Actual Share Volume (per the Company)	Percentage of Total Market Share (per the NASD)	Rank	Actual Share Volume (per the Company)	Percentage of Total Market Share (per the NASD)	Rank
	(in thousands)			(in thousands)		
2000						
December...	1,706,130	44.44%	1	275,113	47.23%	1
November...	1,390,149	39.68	1	207,453	40.64	1
October....	1,705,502	44.73	1	215,492	50.80	1
September..	1,481,456	42.88	1	187,327	54.59	1
August.....	1,502,646	42.02	1	196,967	64.66	1
July.......	1,423,374	42.27	1	162,152	63.74	1
June.......	1,483,229	39.72	1	171,947	62.25	1
May........	1,339,223	40.35	1	164,623	57.66	1
April......	1,411,490	44.35	1	222,335	53.56	1
March......	1,925,755	46.24	1	339,839	64.12	1
February...	1,514,948	46.03	1	310,291	72.34	1
January....	1,628,928	45.53	1	243,403	69.75	1
1999						
December...	1,788,540	46.62%	1	221,055	71.14%	1
November...	1,532,737	45.53	1	151,589	63.18	1
October....	1,315,366	43.38	1	130,091	54.27	1
September..	1,113,662	42.54	1	137,644	56.04	1
August.....	1,132,051	42.10	1	139,916	62.85	1
July.......	1,179,969	43.98	1	131,108	68.31	1
June.......	1,135,648	42.13	1	126,183	58.56	1

May........	1,205,532	44.58	1	133,948	67.53	1
April......	1,422,670	45.31	1	158,074	67.26	1
March......	1,346,064	43.82	1	149,563	65.19	1
February...	1,041,342	41.89	1	115,705	65.83	1
January....	1,089,872	42.70	1	107,789	67.56	1

Clients

Our clients include national and regional full-service broker-dealers, discount brokers, institutional investors and electronic communication networks. We believe that Knight Trading Group is the largest execution destination for all equity transactions originated on the Internet.

The fastest growing component of our revenue comes from institutional investors. Our institutional investors include mutual funds, investment advisors, pension plan sponsors, trusts and endowments. We intend to continue growing our institutional sales force to support our growing institutional client base.

In 2000, our largest client accounted for 11.6% of our equity order flow as measured in share volume. No other client accounted for over 10% of our equity order flow as measured in share volume.

Marketing

We seek to increase our market share through television and print advertising, advertising on our Web site and a public relations program. Our marketing focuses on advertising our execution services in publications

targeted at the securities industry. In addition, we have a quarterly program of targeted mailings to existing and potential broker-dealer and institutional clients.

We also market aggressively through one-on-one meetings with clients and potential clients, and continuous communications with existing clients. Our marketing strategy is to continue to differentiate Knight Trading Group from competitors by enhancing its reputation and brand as the provider of highest quality execution solutions and liquidity with superior customer service.

We also sponsor the Knight Senior Advisory Committee, which is a committee of senior securities industry professionals that meet to discuss operational procedures, strategic direction and their trading partnership with us. During these meetings, we attempt to enhance communications between firms and address our clients' concerns, questions and ideas.

Clearing Arrangements

In October 1999, KS began clearing all of its trades through Broadcourt Clearing Corp., a subsidiary of Merrill Lynch & Co. The contract between the parties will remain in effect until terminated by either party upon sixty days' prior written notice or upon thirty days' written notice in certain limited circumstances. KSIL clears through Merrill Lynch International, also a subsidiary of Merrill Lynch & Co. KCM clears all of its trades through National Investor Services Corp., a subsidiary of TD Waterhouse Group, Inc. The contract will remain in effect until terminated by either party upon sixty days' prior written notice. KFP clears the majority of its trades through First Options of Chicago, a subsidiary of Goldman Sachs Group, Inc.

Technology

Our success is largely attributable to management's ability to identify and deploy emerging technologies that facilitate the execution of trades. Technology has not only enhanced our ability to handle order flow, it has also been an important component of our strategy to comply with government regulations, achieve the highest execution standards and provide superior client service. We also use our proprietary technology and technology licensed from third parties to monitor proactively the performance of our traders, to assess our inventory positions and to provide ongoing information to our clients. We are electronically linked to our broker-dealer and institutional clients through dedicated servers. Our trading volume is transacted over dedicated communications networks, which provide immediate access to our trading operations and facilitate the handling of client orders. We plan to continue to make additional investments in technology and to automate further our execution services.

Architectural Design and Industry Standards. Our systems are designed to be open, interoperable, scalable, redundant and flexible. We utilize leading edge technologies including Sun Microsystems, Inc.'s client /server architecture, C/C++ programming languages, Java, relational database management systems and on-line analytical processing.

Electronic Commerce. Our electronic commerce architecture enables our broker-dealer and institutional clients to send their orders through a variety of electronic communications gateways, including the Internet and direct client interfaces over our private network. Our clients can use their own order management system, an institutional portfolio management system or can select from a variety of our electronic connections.

Trading Systems. KS, KSIL and KSJ use the BRASS(R) trading system designed by SunGard. This system has a client /server architecture that uses Sun Microsystems, Inc. workstations and servers. KS, KSIL and KSJ run a local version of BRASS(R). KS, KSIL and KSJ also make extensive use of application program interfaces, commonly known as APIs to develop software applications.

KCM uses the Appletree trading system designed by TCAM. This system runs on Stratus Computer Inc.'s fault tolerant platform. KCM has also developed software applications using APIs.

KFP uses an inhouse developed proprietary system to make markets on five major option exchanges in the U.S. The system supports screen based trading as well as floor trading. The system has a distributed architecture which can be run on Sun Microsystems Platforms and MS Windows NT Platforms.

Disaster Recovery Center. We currently operate a back-up data center at a leased facility in Weehawken, NJ. This facility is used primarily to backup or support our trading data and processing if a disaster or major system malfunction occurs. To provide for system continuity in the event of short power outages, we have also equipped our three data centers and trading rooms with uninterruptible power supply units and back up generators.

A larger facility in Fairfield, NJ is now being constructed to replace the Weehawken operation and provide expanded back-up capability. The Fairfield center will run a "hot" realtime copy of all our trading data and provide back-up realtime operation to support trading floors at the Jersey City offices. The Fairfield center will also support a small number of traders on site.

Competition

Through 2000, we derived substantially all of our revenues from market-making and asset management activities. The market for these services, particularly market-making services through electronic communications networks ("ECNs"), is rapidly evolving and intensely competitive. We expect competition to continue and intensify in the future. KS and KSIL competes primarily with wholesale, national, and regional broker-dealers, as well as ECNs. KCM competes with the NYSE, the AMEX, regional exchanges, other broker-dealer competitors and ECNs. KFP competes with other options specialists and market makers, while Deephaven competes with other asset management companies. We compete primarily on the basis of execution standards, our relationship with our clients and technology.

A number of our competitors have significantly greater financial, technical, marketing and other resources than we have. Some of our competitors also offer a wider range of services and products than we offer and have greater name recognition and more extensive client bases. These competitors may be able to respond more quickly to new or evolving opportunities, technologies and client requirements than we can and may be able to undertake more extensive promotional activities and offer more attractive terms to clients. Recent advancements in computing and communications technology are substantially changing the means by which market-making services are delivered, including more direct access on-line to a wide variety of services and information, and have also created demand for more sophisticated levels of client service. The provision of such services may entail considerable cost without an offsetting increase in revenues. Moreover, current and potential competitors have established or may establish cooperative relationships among themselves or with third parties or may consolidate to enhance their services and products. New competitors or alliances among competitors may emerge and they may acquire significant market share. All of these above factors may affect us in the future.

ECNs. An electronic communications network, commonly referred to as an ECN, is defined by the SEC as "any electronic system that widely disseminates to third parties limit orders entered therein by an exchange market maker or OTC market maker and permits such orders to be executed against, in whole or in part." ECNs are private trading systems used by institutional investors and broker-dealers, including market makers and day trading firms. ECNs provide market participants with the ability to trade securities anonymously, manage inventory and to obtain immediate display of their limit orders. ECNs, however, merely provide a neutral forum in which third parties can display and match their limit orders.

As ECNs do not buy or sell securities as principal they cannot provide enhanced liquidity to investors. ECNs essentially are private limit order files that are highly dependent on trade volume and price volatility to be effective. In the absence of high trade count or wide price fluctuations in a particular security, the rapidity of execution and overall fill rates in an ECN can suffer. Consequently, ECNs have their greatest value in a select few Nasdaq stocks with the greatest levels of trade volume and price fluctuations.

11

Employees

At December 31, 2000, we had a total of 1,364 full-time employees, of which 672 were employed at KS, 144 were employed at KCM, 379 were employed at KFP and Deephaven, 139 were employed at KSIL and 30 were employed at KSJ. Of KS's 672 employees, 387 were engaged in market-making and sales activities, 136 in systems and technology, 67 in client service and 82 in administration. Of KCM's

144 employees, 84 were engaged in market-making activities, 29 in client service, 15 in systems and technology and 16 in administration. Of KFP and Deephaven's 379 employees, 264 were engaged in market-making and sales activities, 63 in systems and technology, 5 in client service and 47 in administration. None of our employees are subject to a collective bargaining agreement. We believe that our relations with our employees are excellent.

We recruit and retain our employees by compensating them largely on a performance basis, measuring performance primarily in terms of revenue generation. We are committed to improving the skill levels of our employees and, to that end, we have established Knight School, formal training sessions in which trading staff learn new trading techniques and are informed of regulatory developments. We are continuing to expand this initiative and to develop additional programs to improve the skills and productivity of our work force.

Intellectual Property and Other Proprietary Rights

We rely primarily on trade secret and trademark law to protect our proprietary technology. Notwithstanding the precautions we take to protect our intellectual property rights, it is possible that third parties may copy or otherwise obtain and use our proprietary technology without authorization or otherwise infringe on our proprietary rights. It is also possible that third parties may independently develop technologies similar to ours. It may be difficult for us to police unauthorized use of our intellectual property rights. In addition, litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets, to determine the validity and scope of the proprietary rights of others, or to defend against claims of infringement or invalidity. These litigations, whether successful or unsuccessful, could result in substantial costs and diversions of resources either of which could have a material adverse effect on our business, financial condition and operating results. We may in the future receive notices of claims of infringement of other parties' proprietary rights.

Government Regulation

The securities industry in the United States is subject to extensive regulation under both federal and state laws. In addition, the SEC, the NASD, other self regulatory organizations, commonly known as SROs, such as the various stock exchanges, and other regulatory bodies, such as state securities commissions, require strict 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 clients participating in those markets, not protecting creditors or stockholders of market makers. Market makers are subject to regulation concerning certain aspects of their business, including trade practices, capital structure, record retention and the conduct of 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 its directors, officers or employees, and other adverse consequences. We and certain of our officers and other employees have, in the past, been subject to claims arising from the violation of such laws, rules and regulations, which resulted in the payment of fines and settlements.

The regulatory environment in which we operate is subject to change. Our business, financial condition and operating results may be adversely affected as a result of new or revised legislation or regulations imposed by the SEC, other United States or foreign governmental regulatory authorities or the NASD. Our business, financial condition and operating results also may be adversely affected by changes in the interpretation or enforcement of existing laws and rules by these governmental authorities and the NASD.

Additional regulation, changes in existing laws and rules, or changes in interpretations or enforcement of existing laws and rules often directly affect the method of operation and profitability of securities firms. We cannot predict what effect any such changes might have. Both regulations directly applicable to us and regulations of general application could have a material adverse effect on our business, financial condition, and operating results. For example, the volume of our market-making activities in a given period could be affected by, among other things, existing and proposed tax legislation, antitrust policy and other governmental regulations and policies (including the interest rate policies of the Federal Reserve Board) and changes in interpretation or enforcement of existing laws and rules that affect the business and financial communities. The level of trading and market-making activity can be affected not only by such legislation or regulations of general applicability, but also by industry-specific legislation or regulations.

Our business, both directly and indirectly, relies on the Internet and other electronic communications gateways. We intend to expand our use of these gateways. To date, the use of the Internet has been relatively free from regulatory restraints. However, the SEC, certain SROs and certain states are beginning to address the regulatory issues that may arise in connection with the use of the Internet. Accordingly, new regulations or interpretations may be adopted that constrain our own and our clients' abilities to transact business through the Internet or other electronic communications gateways.

In addition, we have established London and Japan-based subsidiaries and intend to expand our business to other countries in the future. To expand our services internationally, we will have to comply with the regulatory controls of each country in which we conduct business. The brokerage industry in many foreign countries is heavily regulated. The varying compliance requirements of these different regulatory jurisdictions and other factors may limit our ability to expand internationally.

Termination of SEC's KCM Inquiry

In 1996, the SEC advised KCM that it was conducting an inquiry with respect to KCM and asked that KCM voluntarily provide the SEC certain documents. At such time, based on the request for documents, it appeared that the SEC's inquiry concerned four areas: price improvement, protection of limit orders, payment for order flow and trade reporting. This inquiry was disclosed in the Company's initial public offering and follow-on offering prospectus'.

On January 5, 2000, the staff of the SEC notified counsel for KCM that it intended to recommend an administrative and cease and desist proceeding against KCM and its then president, Steven Steinman, for alleged violations of Sections 10(b) and 15(c)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") and Rules 10b-5 and 15c1-2 promulgated thereunder. On January 28, 2000, KCM and Mr. Steinman filed a submission with the SEC staff setting out their reasons why there was no basis for the staff's allegations. By letter dated February 16, 2000, the SEC staff notified KCM and Mr. Steinman that the staff was terminating its inquiry dating back to 1996 and that no enforcement action was recommended.

Net Capital Requirements

As registered broker-dealers and members of the NASD, certain of our subsidiaries are subject to the SEC's Net Capital Rule. The Net Capital Rule, which specifies minimum net capital requirements for registered broker-dealers, is designed to measure the general financial integrity and liquidity of a broker-dealer and requires that at least a minimum part of its assets be kept in relatively liquid form. In general, net capital is defined as net worth (assets minus liabilities), plus qualifying subordinated borrowings and certain discretionary liabilities, and less certain mandatory deductions that result from excluding assets that are not readily convertible into cash and from valuing conservatively certain other assets. Among these deductions are adjustments, which are commonly called haircuts, which reflect the possibility of a decline in the market value of an asset prior to disposition.

13

Failure to maintain the required net capital may subject a firm to suspension or revocation of registration by the SEC and suspension or expulsion by the NASD and other regulatory bodies and ultimately could require the firm's liquidation. The Net Capital Rule prohibits payments of dividends, redemption of stock, the prepayment of subordinated indebtedness and the making of any unsecured advance or loan to a stockholder, employee or affiliate, if such payment would reduce the firm's net capital below required levels.

The Net Capital Rule also provides that the SEC may restrict for up to 20 business days any withdrawal of equity capital, or unsecured loans or advances to stockholders, employees or affiliates (capital withdrawal), if such capital withdrawal, together with all other net capital withdrawals during a 30-day period, exceeds 30% of excess net capital and the SEC concludes that the capital withdrawal may be detrimental to the financial integrity of the broker-dealer. In addition, the Net Capital Rule provides that the total outstanding principal amount of a broker-dealer's indebtedness under certain subordination agreements, the proceeds of which are included in its net capital, may not exceed 70% of the sum of the outstanding principal amount of all subordinated indebtedness included in net capital, par or stated value of capital stock, paid in capital in excess of par, retained earnings and other capital accounts for a period in excess of 90 days.

A change in the Net Capital Rule, the imposition of new rules or any unusually large charges against net capital could limit those of our operations that require the intensive use of capital and also could restrict our ability to withdraw capital from our broker-dealer subsidiaries, which in turn could limit our ability to pay dividends, repay debt and repurchase shares of our outstanding stock. A significant operating loss or any unusually large charge against net capital could adversely affect our ability to expand or even maintain our present levels of business.

Additionally, our foreign subsidiaries in London and Japan are subject to capital adequacy requirements of the Securities and Futures Authority Limited in the United Kingdom and the Financial Service Industry in Japan, respectively.

Item 2. Properties

Our headquarters are located in Jersey City, New Jersey. We lease approximately 105,053 square feet under a lease which expires in March 2006, and we have an option to extend the lease term on three floors for an additional five-year period. We also lease approximately 183,202 square feet for our offices in Purchase, NY; Minnetonka, MN, Chicago, IL; Santa Clara, CA; Boston, MA; Jericho, NY; London, England and Japan. Our London lease represents space leased on the former floor of the London Stock Exchange.

In July 2000, we signed a lease for our new world headquarters in Jersey City, NJ. The new headquarters will be located at 545 Washington Boulevard in Jersey City, a building now under construction adjacent to our current headquarters at 525 Washington Boulevard. We have leased approximately 266,000 square feet in our new building, and anticipate occupying our new space during the fourth quarter of 2001.

We believe that our present facilities, together with our current options to extend lease terms and occupy additional space, are adequate for our current needs.

Item 3. Legal Proceedings

We are not currently a party to any legal proceedings, the adverse outcome of which, individually or in the aggregate, we can predict with any reasonable certainty, could have a material adverse effect on our business, financial condition or operating results. We and certain of our past and present officers and employees are currently the subject of legal proceedings, such as those stated in our 8-K filing of November 30, 2000, that are in their preliminary stages. As such, we are unable to predict the outcome of any such proceeding and assess or quantify the potential damages, if any.

14

Item 4. Submission of Matters to a Vote of Security Holders

None.

PART II

Item 5. Market for Registrant's Common Equity and Related Stockholder Matters

Our Class A Common Stock is traded on the Nasdaq National Market under the symbol "NITE." Public trading of our Class A Common Stock commenced on July 8, 1998. Before that, no public market for our Class A Common Stock existed. The following table sets forth, for the past two years, the high and low quarterly sales price per share of the Class A Common Stock in the Nasdaq National Market (adjusted for our stock split in May 1999):

1999		
First Quarter.	$33.81	$10.00
Second Quarter	81.63	32.50
Third Quarter.	64.81	26.25
Fourth Quarter	57.50	21.69
2000		
First Quarter.	60.06	29.50
Second Quarter	53.00	24.31
Third Quarter.	39.75	25.00
Fourth Quarter	35.73	13.88

As of March , 2001, there were approximately holders of record of our Class A Common Stock.

We have never paid a dividend. We intend to retain future earnings, if any, to finance the development and expansion of our business and, therefore, do not anticipate paying any cash dividends in the foreseeable future. The payment of cash dividends is within the discretion of our board of directors and will depend on many other factors, including our results of operations, financial condition and capital requirements, restrictions imposed by financing arrangements and legal requirements.

Item 6. Selected Financial Data

The following selected consolidated financial data are qualified by the Consolidated Financial Statements of Knight Trading Group, Inc. and the Notes thereto included elsewhere in this document. You should read the following in conjunction with the Consolidated Financial Statements and the discussion under "Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this document. The Consolidated Statements of Income Data for the years ended December 31, 1998, 1999 and 2000 and the Consolidated Statements of Financial Condition Data at December 31, 1999 and 2000 have been derived from our audited Consolidated Financial Statements included elsewhere in this document. The Consolidated Statements of Income Data for the years ended December 31, 1996 and 1997 and the Consolidated Statements of Financial Condition Data at December 31, 1996, 1997 and 1998 are derived from Consolidated Financial Statements not included in this document.

	For the years ended D		
	2000	1999	1998
	(In thousands, except share		
Consolidated Statement of Income Data:			
Revenues...			
Net trading revenue......................................	$ 1,157,516	$ 845,105	$ 395,4
Asset management fees....................................	41,884	19,921	6,1
Interest and dividends, net of interest expense.........	16,137	11,950	3,9
Commissions and fees.....................................	32,158	16,439	3,9
Investment income and other..............................	9,225	3,160	1,5
Total revenues...	1,256,920	896,575	411,0
Expenses			
Employee compensation and benefits......................	421,170	269,224	123,0
Payments for order flow..................................	174,646	138,697	82,4
Execution and clearance fees.............................	112,238	89,575	50,7
Communications and data processing......................	33,025	18,944	11,7
Depreciation and amortization............................	25,336	11,396	7,2
Professional fees..	21,527	7,889	4,5
Occupancy and equipment rentals..........................	18,742	10,706	6,1
Business development.....................................	14,806	10,295	2,9
Merger related costs.....................................	--	9,969	
Interest on preferred units..............................	--	--	7
Other..	16,899	7,050	3,4
Total expenses...	838,389	573,745	292,9
Income before income taxes and minority interest..........	418,531	322,830	118,0
Income tax expense.......................................	159,446	111,546	22,2
Income before minority interest..........................	259,085	211,284	95,8
Minority interest in consolidated subsidiaries...........	837	--	
Net income...	$ 259,922	$ 211,284	$ 95,8

Basic earnings per share	$ 2.12	$ 1.75	$ 0.
Diluted earnings per share	$ 2.05	$ 1.68	$ 0.
Pro forma adjustments			
Income before income taxes and minority interest	$ 418,531	$ 322,830	$ 118,0
Adjustment for pro forma employee compensation and benefits (1)	(267)	(7,580)	(5,0
Pro forma income before income taxes and minority interest	418,264	315,250	112,9
Pro forma income tax expense (2)	160,089	126,790	48,0
Pro forma income before minority interest	258,175	188,460	64,9
Minority interest in consolidated subsidiaries	837	--	
Pro forma net income	$ 259,012	$ 188,460	$ 64,9
Pro foma basic earnings per share	$ 2.11	$ 1.56	$ 0.
Pro forma diluted earnings per share	$ 2.04	$ 1.50	$ 0.
Shares used in basic earnings per share calculations (3)	122,520,733	120,821,710	103,115,7
Shares used in diluted earnings per share calculations (3)	126,863,316	125,755,430	103,115,7

	December 31,				
	2000	1999	1998	1997	199
Consolidated Statement of Financial Condition Data:					
Cash and cash equivalents	$ 364,058	$ 304,054	$117,705	$ 13,918	$ 15,
Securities owned, at market value	1,799,967	910,233	411,288	180,957	72,
Receivable from clearing brokers	114,047	215,423	107,537	35,747	33,
Total assets	2,521,409	1,540,286	684,644	264,788	146,
Securities sold, not yet purchased, at market value	1,427,214	720,919	328,171	125,827	39,
Mandatorily Redeemable Preferred Units	--	--	--	27,484	37,
Total stockholders' (members') equity	774,186	499,231	205,873	61,804	39,

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(1) Before the merger, Arbitrade was a limited liability company and compensation and benefits to Arbitrade's members were accounted for as distributions of members' equity. Pro forma compensation expense was computed as 15% of the before-tax profits earned by Arbitrade for the years ended December 31, 1996, 1997, 1998 and 1999 and for the period ended January 12, 2000, the date of the merger.

(2) Before our initial public offering in July 1998, we were a limited liability company and were not subject to income taxes. Pro forma income tax expense was computed based on an effective tax rate of 43%, 43% and 42.5%, for the years ended December 31, 1996 and 1997, and for the period through our initial public offering in 1998, respectively. Additionally, before our merger, Arbitrade was a limited liability company and was not subject to taxes. Pro forma income tax expense was computed based on Arbitrade's income at an effective tax rate of 42.5% for the years ended

December 31, 1996, 1997, 1998, 1999 and for the period ended January 12, 2000.

(3) Weighted average shares outstanding for all years presented have been determined as if the merger and reorganization described in Notes 1 and 3 to the Consolidated Financial Statements included elsewhere in this document occurred as of the earliest date presented. Shares issued in connection with our initial public offering have been considered in determining weighted average shares outstanding only from the date they were issued.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are the leading market maker in Nasdaq securities, other OTC equity securities, and the over-the-counter market for NYSE- and AMEX-listed equity securities. Through our wholly-owned subsidiary, Knight Securities, ("KS"), we make markets in approximately 9,100 equity securities in Nasdaq and on the NASD's OTC Bulletin Board. Through our wholly-owned subsidiary, Knight Capital Markets ("KCM"), we make markets in the over-the-counter market for all NYSE- and AMEX-listed equity securities. We are also a leading market maker in options on individual equities, equity indices and fixed income instruments in the U.S. and Europe through our Knight Financial Products ("KFP") subsidiary. We also maintain an asset management business for institutional investors and high net worth individuals through our Deephaven subsidiaries.

The Company has two reportable business segments: securities market-making and asset management. Securities market-making primarily includes the operations of KS, KCM and KFP and includes market-making in equity securities listed on Nasdaq, on the OTCBB of the NASD, in the over-the-counter market for NYSE- and AMEX-listed securities and in options on individual equities, equity indices, fixed income instruments and certain commodities. The asset management segment includes the operations of Deephaven Capital Management, Deephaven Capital and Deephaven Investment Advisers and consists of investment management and sponsorship for a series of private investment funds.

KS commenced Nasdaq and OTC securities market-making operations on July 24, 1995. Based on rankings published by The AutEx Group, KS was ranked first in AutEx's Nasdaq/OTC Securities rankings during 2000. KS's equity share volume totaled 27.4 billion, 64.0 billion and 90.8 billion, or 71%, 79% and 81% of our total equity share volume, for the years ended December 31, 1998, 1999 and 2000, respectively. Since commencing operations in 1995, KS's business has grown rapidly and accounted for 80%, 86% and 86% of our total equity share volume growth during the years ended December 31, 1998, 1999 and 2000, respectively. Since our acquisition of KCM in March 1995, KCM has also experienced significant increases in equity share volume. In addition, KCM has held the #1 market share ranking in trading of securities in the over-the-counter market for NYSE- and AMEX-listed securities for over two years as disclosed by the NASD. KCM's equity share volume totaled 11.0 billion, 17.0 billion and 21.2 billion, or 29%, 21% and 19% of our total equity share volume for the years ended December 31, 1998, 1999 and 2000, respectively. KFP commenced its options market-making and

specialist business in 1995. KFP's U.S. option contract volume amounted to 5.6 million, 10.6 million and 21.4 million for the years ended December 31, 1998, 1999 and 2000.

We have experienced, and expect to continue to experience, significant fluctuations in operating results due to a variety of factors, including the value of our securities positions and our ability to manage the risks attendant thereto, the volume of our market-making activities, volatility in the securities markets, our ability to manage personnel and expenses, the amount of revenue derived from limit orders as a percentage of net trading revenues, changes in payments for order flow or clearing costs, the addition or loss of sales and trading professionals, regulatory changes, the amount and timing of capital expenditures, the incurrence of costs associated with acquisitions and general market conditions. If demand for our market-making services declines and we are unable to adjust our cost structure on a timely basis, our operating results could be materially and adversely affected. We have experienced, and may experience in the future, significant seasonality in our business.

Due to all of the foregoing factors, period-to-period comparisons of our revenues and operating results are not necessarily meaningful and such comparisons cannot be relied upon as indicators of future performance. There also can be no assurance that we will be able to sustain the rates of revenue growth that we have experienced in the past, that we will be able to improve our operating results or that we will be able to sustain our profitability on an annual and/or quarterly basis.

Revenues

Our revenues consist principally of net trading revenue from securities market-making activities. Net trading revenue, which represents trading gains net of trading losses, is primarily affected by changes in equity trade and share volumes and option contract volumes, our ability to derive trading gains by taking proprietary positions, changes in our execution standards, volatility in the marketplace and by regulatory changes and evolving industry customs and practices. Our net trading revenue per trade for OTC securities has historically exceeded the net trading revenue per trade for listed securities.

We continue to focus on increasing our institutional business. OTC securities transactions with institutional customers are executed as principal, and all related profits and losses are included within net trading revenue. Listed securities transactions with institutional customers are executed on an agency basis, for which we earn commissions on a per share basis. We also receive fees for providing certain information to market data providers and for directing trades to certain destinations for execution. Commissions and fees are primarily affected by changes in our trade and share volumes in listed securities.

Asset management fees represent fees earned for sponsoring and managing the investments of private investment funds. Asset management fees are primarily affected by the rates of return earned on the funds we manage and changes in the amount of assets under management.

We earn interest income from our cash held at banks and cash held in trading accounts at clearing brokers, net of transaction-related interest charged by clearing brokers for facilitating the settlement and financing of securities transactions, and interest on subordinated notes and short-term debt. Net interest is primarily affected by the changes in cash balances held at banks and clearing brokers, the level of securities positions, and the principal amount outstanding under subordinated notes and short-term debt.

Expenses

Our operating expenses largely consist of employee compensation and benefits, payments for order flow and execution and clearance fees. A substantial portion of these expenses is variable in nature. Employee compensation and benefits expense, which is largely profitability based, fluctuates, for the most part, based on changes in net trading revenue and our profitability. Payments for order flow fluctuate based on equity share volume, the mix of market orders and limit orders and the mix of orders received from broker-dealers who accept payments for order flow. Execution and clearance fees fluctuate primarily based on changes in equity trade and

share volume, the mix of trades of OTC securities compared to listed securities, clearance fees charged by clearing brokers and ECN fees. Our international expansion efforts have generally increased our operating expenses.

Employee compensation and benefits expense primarily consists of salaries and wages paid to administrative and customer service personnel and profitability based compensation, which includes compensation and benefits paid to market-making and sales personnel based on their individual performance, and incentive compensation paid to all other employees based on our overall profitability. Profitability based compensation represented 77%, 82% and 79% of total employee compensation and benefits expense for the years ended December 31, 1998, 1999 and 2000 respectively. We have grown from 551 employees at December 31, 1998 to 803 and 1,364 employees as of December 31, 1999 and 2000, respectively. Approximately 69% of our employees are directly involved in market-making, sales or customer service activities. Compensation for employees engaged in market-making and sales activities, the largest component of employee compensation and benefits, is determined primarily based on a percentage of gross trading profits net of expenses including payments for order flow, execution and clearance costs and overhead allocations.

Payments for order flow represent customary payments to broker-dealers, in the normal course of business, for directing their order flow in equity securities to us. As a result of the new Order Handling Rules implemented by the SEC in 1997, we changed our order flow payment policy from paying broker-dealers for substantially all order executions, to paying broker-dealers only for orders which provide us with a profit opportunity. For example, we make payments on market orders, but do not pay on limit orders. Payments for order flow change as we modify our payment formulas and as our percentage of customers whose policy is not to accept payments for order flow varies.

Execution and clearance fees primarily represent clearance fees paid to clearing brokers for OTC and listed securities, transaction fees paid to Nasdaq, payments made to third parties for exchange seat leases and execution fees paid to third parties, primarily for executing trades in listed securities on the NYSE and AMEX and for executing orders through electronic communications networks, commonly referred to as ECNs. Due to our significant equity share and trade volume, we have been able to negotiate favorable rates and volume discounts from clearing brokers and providers of execution services. As a result of these lower rates and discounts and the increase in equity trade volume of OTC securities as a percentage of total trade volume, execution and clearance fees per trade have decreased.

Communications and data processing expense primarily consists of costs for obtaining stock market data and telecommunications services.

Depreciation and amortization expense results from the depreciation of fixed assets and the amortization of goodwill, which includes contingent consideration primarily resulting from the acquisition of the listed securities market-making businesses of KCM and Tradetech Securities, L.P. ("Tradetech") Depreciation and amortization expense also includes the amortization of goodwill related to our purchases of various options-related businesses.

Professional fees primarily consist of fees paid to computer programming and systems consultants, as well as legal fees and other professional fees.

Occupancy and equipment rentals expense primarily consists of rental payments on office and equipment leases.

Business development expense primarily consists of advertising costs and marketing expenses, including travel and entertainment expenses and promotion costs.

Interest on Preferred Units represents required interest payments on our Mandatorily Redeemable Preferred A and B Units at a rate approximating the Federal Funds rate. On April 15, 1998, we redeemed all of the remaining outstanding Preferred A Units for $12.5 million in cash. On April 15, 1998, we redeemed $1.2 million of Preferred B Units and, on July 17, 1998, we used $13.8 million of the proceeds from our initial public offering to redeem all of the remaining outstanding Preferred B Units.

19

Merger-related expenses primarily consist of investment banking, legal and accounting costs incurred in connection with our merger with Arbitrade Holdings LLC This transaction closed in January 2000.

Other expenses primarily consist of administrative expenses and other operating costs.

Income Tax

Prior to our initial public offering, we were a limited liability company and were not subject to federal or state income taxes. Actual income tax expense represents income taxes incurred from July 13, 1998, the date of the reorganization, through December 31, 1998 and for the years ended December 31, 1999 and 2000. This period is referred to as the post-offering period. Additionally, prior to the merger with KFP, KFP was a limited liability company, which was treated as a partnership for tax purposes and its U.S. federal and state income taxes were borne by KFP's individual partners. As such KFP's historical financial statements only include a provision for non-U.S. income taxes. Subsequent to the merger, KFP's income is subject to federal income taxes and state income taxes. This period is referred to as the post-merger period. Our effective tax rate for the post-offering period and post-merger period and proforma effective tax rate for all periods prior to the post-offering period and post-merger period, differ from the federal statutory rate of 35% due to state income taxes, as well as nondeductible expenses, including the amortization of goodwill resulting from the acquisition of Trimark and a portion of business development expenses and merger-related expenses.

Results of Operations

The following table sets forth the consolidated statement of income data as a percentage of total revenues:

	For the years ended December 31,		
	2000	1999	1998
Revenues			

Net trading revenue	92.1%	94.3%	96.2%
Asset management fees	3.3	2.2	1.5
Interest and dividends, net of interest expense.	1.3	1.3	1.0
Commissions and fees	2.6	1.8	1.0
Investment income and other	0.7	0.4	0.3
Total revenues	100.0	100.0	100.0
Expenses			
Employee compensation and benefits	33.5	30.0	29.9
Payments for order flow	13.9	15.5	20.1
Execution and clearance fees	8.9	10.0	12.3
Communications and data processing	2.6	2.1	2.9
Depreciation and amortization	2.0	1.3	1.8
Professional fees	1.7	0.9	1.1
Occupancy and equipment rentals	1.5	1.2	1.5
Business development	1.2	1.1	0.7
Merger related costs	0.0	1.1	0.0
Other	1.3	0.8	1.0
Total expenses	66.6	64.0	71.3
Income before income taxes and minority interest	33.4%	36.0%	28.7%
Income tax expense	12.7	12.4	5.4
Income before minority interest	20.7	23.6	23.3
Minority interest in consolidated subsidiaries	0.1	0.0	0.0
Net income	20.8%	23.6%	23.3%

	2000	1999	1998
Pro forma adjustments			
Income before income taxes and minority interest	33.4	36.0	28.7
Adjustment for pro forma employee compensation and benefits	0.0	-0.8	-1.2
Pro forma income before income taxes and minority interest.	33.4	35.2	27.5
Pro forma income tax expense	12.7	14.1	11.7
Pro forma income before minority interest	20.7	21.1	15.8
Minority interest in consolidated subsidiaries	0.1	0.0	0.0
Pro forma net income	20.8%	21.1%	15.8%

Years Ended December 31, 2000 and 1999

Revenues

Net trading revenue increased 37.0% to $1,157.5 million in 2000, from $845.1 million in 1999. This increase was primarily due to higher equity share and option contract volumes, particularly higher equity share volume for OTC securities. Total equity share volume increased 38.3% to 112.1 billion shares in 2000, from 81.0 billion shares in 1999. Total equity trade volume increased 57.4% to 142.7 million trades in 2000, from 90.7 million trades in 1999. The effect of these volume increases were offset partially by the fact that average net revenue per equity share decreased from $0.0095 per equity share in 1999 to $0.0092 per equity share in 2000.

Asset management fees increased 110.2% to $41.9 million in 2000 from $19.9 million in 1999. The increase in fees was primarily due to an increase in fund return in our Deephaven Market Neutral Master Fund from 21.08% in 1999 to 33.61% in 2000. Additionally, there was an increase in funds under management from $314.3 million at December 31, 1999 to $743.5 million at December 31, 2000. The Deephaven Market Neutral Master Fund, represents the majority of our funds under management.

Interest income, net of interest expense, increased 35.0% to $16.1 million in 2000, from $11.9 million in 1999. This increase was primarily due to larger cash balances held at banks and our clearing brokers.

Commissions and fees increased 95.6% to $32.2 million in 2000, from $16.4 million in 1999. This increase is primarily due to higher equity share volumes from institutional customers in listed securities, higher fees for providing certain information to market data providers and for directing trades to certain destinations for execution.

Investment income and other income increased 191.9% to $9.2 million in 2000, from $3.2 million in 1999. This increase was primarily due to an increase in income from our investments in the private hedge funds that we sponsor and manage.

Expenses

Pro forma employee compensation and benefits expense increased 52.3% to $421.4 million in 2000, from $276.8 million in 1999. As a percentage of total revenue, pro forma employee compensation and benefits expense was 33.5% in 2000 and 30.8% in 1999. The increase on a dollar basis was primarily due to increases in gross trading profits and growth in our number of employees. The increase on a percentage basis is primarily due to an increase in our number of employees and the decrease in average net revenue per equity share. Due to increased net trading revenue and profitability, pro forma profitability based compensation increased 46.4% to $331.8 million in 2000, from $226.6 million in 1999. The number of employees increased to 1,364 employees as of December 31, 2000, from 803 employees as of December 31, 1999.

Payments for order flow increased 25.9% to $174.6 million in 2000, from $138.7 million in 1999. As a percentage of total revenue, payments for order flow decreased to 13.9% in 2000 from 15.5% in 1999. The increase in payments for order flow on a dollar basis was primarily due to a 38.3% increase in equity shares traded in 2000 to 112.1 billion equity shares, up from 81.0 billion in 1999, and the introduction of payments for order flow for options during the third quarter of 2000. The decrease in payments for order flow as a percentage of total revenue was primarily due to increases in our institutional, asset management and options trading revenues, respectively, which have less payments for order flow associated with them.

Execution and clearance fees increased 25.3% to $112.2 million in 2000, from $89.6 million in 1999. As a percentage of total revenue, execution and clearance fees decreased to 8.9% in 2000 from 10.0% in 1999. The increase on a dollar basis was primarily due to a 57.4% increase in equity trades executed to 142.7 million equity trades in 2000, from 90.7 million equity trades in 1999 and a 101.6% growth in options contracts executed from 10.6 million options contracts executed in 1999 to 21.4 million in 2000. The increase on a dollar basis was offset, in part, by a decrease in clearance rates charged by clearing brokers and volume discounts. The decrease in execution and clearance fees as a percentage of total revenue was primarily due to the decrease in clearance rates charged by clearing brokers, volume discounts and growth in the volume of OTC securities transactions.

Communications and data processing expense increased 74.3% to $33.0 million in 2000, from $18.9 million in 1999. This increase was generally attributable to higher trading volumes and an increase in the number of employees.

Depreciation and amortization expense increased 122.3% to $25.3 million in 2000, from $11.4 million in 1999. This increase was primarily due to the purchase of approximately $71.0 million of additional fixed assets and leasehold improvements during 2000 and the amortization of goodwill primarily related to the acquisition of the listed securities market-making businesses of KCM and Tradetech and various options related businesses.

Professional fees increased 172.9% to $21.5 million in 2000, up from $7.9 million in 1999. This increase was primarily due to increased consulting expenses related to our investments in technology, our European and Japanese expansion efforts, as well as legal and other professional fees.

Occupancy and equipment rentals expense increased 75.1% to $18.7 million in 2000, from $10.7 million in 1999. This increase was primarily attributable to additional office space and increased computer equipment lease expense.

Business development expense increased 43.8% to $14.8 million in 2000, from $10.3 million in 1999. This increase was primarily the result of increased advertising and higher travel and entertainment costs consistent with the growth in our business and our increased focus on the institutional sales business.

Merger-related expenses primarily consist of investment banking, legal and accounting costs incurred during 1999 in connection with our merger with Arbitrade Holdings LLC. This transaction closed in January 2000.

Other expenses increased 139.7% to $16.9 million in 2000, from $7.1 million in 1999. This was primarily the result of increased administrative expenses and other operating costs in connection with our overall business growth.

Income Tax

Our effective and pro forma effective income tax rates for 2000 and 1999, differ from the federal statutory rate of 35% due to state income taxes, as well as nondeductible expenses, including the amortization of goodwill resulting from the acquisition of KCM and a portion of business development expenses. Our pro forma tax rate declined to 38.1% in 2000 from 39.9% in 1999 primarily due to lower state and local income taxes.

Years Ended December 31, 1999 and 1998

Revenues

Net trading revenue increased 113.7% to $845.1 million in 1999, from $395.4 million in 1998. This increase was primarily due to higher equity share and option contract volumes, particularly higher equity share volume for OTC securities. Total equity share volume increased 111.1% to 81.0 billion equity shares traded in 1999, from 38.4 billion equity shares traded in 1998. Total equity trade volume increased 121.8% to 90.7 million equity trades in 1999, from 40.9 million equity trades in 1998. Average net revenue per equity share increased to $0.0095 per equity share in 1999 from $0.0091 per equity share in 1998, respectively.

Asset management fees increased 224.8% to $19.9 million in 1999, from $6.1 million in 1998. The increase in fees was primarily due to an increase in fund return in our Deephaven Market Neutral Master Fund from 3.18% in 1998 to 21.08% in 1999 as well as the increase in total funds under management which increased from $113.8 million at December 31, 1998 to $314.3 million at December 31, 1999.

Interest income, net of interest expense, increased 200.2% to $11.9 million in 1999, from $4.0 million in 1998. This increase was primarily due to larger cash balances held at banks and our clearing brokers, primarily as a result of our secondary offering in March 1999.

Commissions and fees increased 312.7% to $16.4 million in 1999, from $4.0 million in 1998. This increase is primarily due to higher equity trade and share volumes from institutional customers in listed securities and the receipt of fees for providing certain information to market data providers.

Investment income and other income increased 107.9% to $3.2 million in 1999 from $1.5 million in 1998. This increase was primarily due to an increase in income from our investments, primarily our investments in the private hedge funds that we sponsor and manage.

Expenses

Pro forma employee compensation and benefits expense increased 116.1% to $276.8 million in 1999, from $128.1 million in 1998. As a percentage of total revenue, pro forma employee compensation and benefits expense decreased to 30.8% in 1999, from 31.1% in 1998. The increase on a dollar basis was primarily due to increases in gross trading profits and growth in our number of employees. Due to increased net trading revenue and profitability, pro forma profitability based compensation increased 130.1% to $226.6 million in 1999, from $98.5 million in 1998. The number of employees increased to 803 employees as of December 31, 1999, from 551 employees as of December 31, 1998.

Payments for order flow increased 68.1% to $138.7 million in 1999, from $82.5 million in 1998. As a percentage of total revenue, payments for order flow decreased to 15.5% in 1999 from 20.1% in 1998. The increase in payments for order flow on a dollar basis was primarily due to a 111.1% increase in equity shares traded in 1999 to 81.0 billion equity shares, up from 38.4 billion in 1998. The decrease in payments for order flow as a percentage of total revenue resulted from changes in our order flow payment policy, changes in the mix of market orders versus limit orders, changes in customer mix and increases in our asset management and options trading revenues, respectively.

Execution and clearance fees increased 76.6% to $89.6 million in 1999, from $50.7 million in 1998. As a percentage of total revenue, execution and clearance fees decreased to 10.0% in 1999 from 12.3% in 1998. The increase on a dollar basis was primarily due to a 121.8% increase in equity trades in 1999 and a 89.5% increase in options contracts executed from 5.6 million in 1998 to 10.6 million in 1999, which was offset, in part, by a decrease in clearance rates charged by clearing brokers, and growth in the volume of OTC securities transactions, which have lower execution costs than transactions in listed securities. The decrease in execution and clearance fees as a percentage of total revenue was primarily due to the decrease in clearance rates charged by clearing brokers, and growth in the volume of OTC securities transactions.

Communications and data processing expense increased 61.6% to $18.9 million in 1999, from $11.7 million in 1998. This increase was generally attributable to higher trading volumes and an increase in the number of employees.

Depreciation and amortization expense increased 56.7% to $11.4 million in 1999, from $7.3 million in 1998. This increase was primarily due to the purchase of approximately $19.4 million of additional fixed assets and leasehold improvements during 1999 and the amortization of goodwill related to the acquisition of the listed securities market-making businesses of KCM and Tradetech.

Professional fees increased 74.8% to $7.9 million in 1999, up from $4.5 million in 1998. This increase was primarily due to increased consulting expenses related to our investments in technology, as well as legal and other professional fees.

Occupancy and equipment rentals expense increased 74.4% to $10.7 million in 1999, from $6.1 million in 1998. This increase was primarily attributable to additional office space and increased computer equipment lease expense.

Business development expense increased 253.4% to $10.3 million in 1999, from $2.9 million in 1998. This increase was primarily the result of higher travel and entertainment costs consistent with the growth in our business and our increased focus on the institutional sales business.

Interest on Preferred Units was zero in 1999 due to our redemption of all remaining Preferred A and B Units during 1998.

Merger-related expenses primarily consist of investment banking, legal and accounting costs incurred during 1999 in connection with our merger with Arbitrade Holdings LLC. The transaction closed in January 2000.

Other expenses increased 105.2% to $7.1 million in 1999, from $3.4 million in 1998. This was primarily the result of increased administrative expenses and other operating costs in connection with our overall business growth.

Income Tax

Pro forma income tax expense in 1998 for the period prior to the Company's reorganization and initial public offering in July 1998 and pro forma income tax expense for 1999 were determined using an effective tax rate of 42.5%.

Liquidity

Historically, we have financed our business primarily through cash generated by operations, as well as the proceeds from our initial public and follow-on stock offerings, the private placement of preferred and common units and borrowings under subordinated notes. As of December 31, 2000, we had $2.5 billion in assets, 90% of which consisted of cash or assets readily convertible into cash, principally receivables from clearing brokers and securities owned. Receivables from clearing brokers include interest bearing cash balances held with clearing brokers, including, or net of, amounts related to securities transactions that have not yet reached their contracted settlement date, which is generally within three business days of the trade date. Securities owned principally consist of equity securities that trade in Nasdaq and on the NYSE and AMEX markets and listed options contracts that trade on national exchanges.

Pro forma net income plus depreciation and amortization was $284.3 million, $199.9 million and $72.2 million during 2000, 1999 and 1998, respectively.

Depreciation and amortization expense, which related to fixed assets and goodwill, was $25.3 million, $11.4 million and $7.3 million during 2000, 1999 and 1998, respectively. Capital expenditures were $71.0 million in 2000, $19.4 million in 1999 and $11.4 million in 1998, or 5.7%, 2.2% and 2.8% of total revenues in each year, respectively. Capital expenditures in 2000 primarily related to the

purchase of data processing and communications equipment, as well as leasehold improvements and additional office facilities to support our growth. In acquiring fixed assets, particularly technology equipment, we make a decision about whether to lease such equipment or purchase it outright based on a number of factors including its estimated useful life, obsolescence and cost. Additionally, we made cash payments of $6.3 million, $6.0 million and $4.1 million in 2000, 1999 and 1998, respectively, in connection with our acquisitions of the listed securities market-making businesses of KCM in 1995 and Tradetech in 1997. These arrangements ended during 2000. The aggregate minimum rental commitments for 2001 are $14.8 million. We anticipate that we will meet our 2001 capital expenditure needs out of operating cash flows.

As registered broker-dealers and market makers, KS, KCM, KFP and Knight Execution Partners ("KEP") a subsidiary of KFP, are 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. These regulations also prohibit a broker-dealer from repaying subordinated borrowings, paying cash dividends, making loans to its parent, affiliates or employees, or otherwise entering into transactions which would result in a reduction of its total net capital to less than 120.0% of its required minimum capital. Moreover, broker-dealers, including KS, KCM, KFP and KEP, are required to notify the SEC prior to repaying subordinated borrowings, paying dividends and making loans to its parent, affiliates or employees, or otherwise entering into transactions, which, if executed, would result in a reduction of 30.0% 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 detrimental to the financial integrity of the broker-dealer. At December 31, 2000, KS had net capital of $304.8 million, which was $301.7 million in excess of its required net capital of $3.1 million, KCM had net capital of $58.2 million, which was $56.8 million in excess of its required net capital of $1.4 million, KFP had net capital of $32.4 million, which was $32.1 million in excess of its required net capital of $250,000 and KEP had net capital of $1.4 million, which was $1.1 million in excess of its required net capital of $292,504. Additionally, our foreign subsidiaries in London and Japan are subject to capital adequacy requirements of the Securities and Futures Authority Limited in the United Kingdom and the Financial Supervisory Agency in Japan, respectively. As of December 31, 2000, we were in compliance with the capital adequacy requirements of all of our foreign subsidiaries.

We currently anticipate that available cash resources and credit facilities will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months.

Recently Issued Accounting Standards

In June 1998, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 133, Accounting for Derivative Instruments and Hedging Activities. This statement established accounting and reporting standards for derivative instruments, including certain derivative instruments imbedded in other contracts, and for hedging activities. In June 1999, the FASB issued SFAS No. 137, Accounting for

Derivative Instruments and Hedging Activities--Deferral of the Effective Date of FASB Statement No. 133--an amendment of FASB Statement No. 133. In June 2000, the FASB issued SFAS No. 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities, which is an amendment to SFAS No. 133 and is effective concurrently with SFAS No. 137. We anticipate adopting the provisions of SFAS No. 133, 137 and 138 effective January 1, 2001 and do not believe that the adoption of these statements will have a material impact on our financial statements.

In September 2000, the FASB issued SFAS No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities--a replacement of FASB Statement No. 125. This statement resets accounting standards for differentiating between securitizations and other transfers of financial assets that are sales from transfers that are secured borrowings. The Company adopted certain provisions of SFAS No. 140 as of December 31, 2000 which did not have a material impact on our financial statements. We anticipate adopting the remaining provisions of SFAS No. 140 effective April 1, 2001 and do not believe that the adoption of these provisions statement will have a material impact on our financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Our market-making and trading activities expose our capital to significant risks. These risks include, but are not limited to, absolute and relative price movements, price volatility or changes in liquidity, over which we have virtually no control.

We employ automated proprietary trading and risk management systems which provide real time, on-line risk management and inventory control. We monitor our risks by a constant review of trading positions and their appropriate risk measures. We have established a system whereby transactions are monitored by senior management as are individual and aggregate dollar and inventory position totals, appropriate risk measures and real-time profits and losses. The management of trading positions is enhanced by review of mark-to-market valuations and position summaries on a daily basis.

In the normal course of our equities market-making business, we maintain inventories of exchange-listed and OTC securities. The fair value of these securities at December 31, 2000 and 1999 was $256.4 million and $135.8 million, respectively, in long positions and $70.0 million and $129.8 million, respectively, in short positions. The potential change in fair value, using a hypothetical 10.0% decline in prices, is estimated to be a $18.6 million loss and a $0.6 million loss as of December 31, 2000 and 1999, respectively, due to the offset of losses in long positions with gains in short positions. The following table illustrates, for the period indicated, our average, highest and lowest month-end inventory at market value (based on both the aggregate and the net of the long and short positions of trading securities from our OTC and exchange-listed market-making business).

Equities Market-Making

	Year Ended December 31,					
	2000		1999		1998	
	Aggregate of Long and Short	Net of Long and Short	Aggregate of Long and Short	Net of Long and Short	Aggregate of Long and Short	Long

	Positions	Positions	Positions	Positions	Positions	Po
Average month-end	$315,072,743	$ 62,933,087	$193,579,372	$ 22,266,851	$129,322,342	$
Highest month-end	511,802,399	186,379,465	398,804,534	51,252,815	208,099,843	3
Lowest month-end.	217,495,778	(57,737,157)	147,263,084	(22,736,612)	73,005,491	(5

Beginning in the fourth quarter of 1998 and throughout 1999 and 2000, there has been a sharp increase in the price volatility of many stocks, particularly of technology companies and companies that sell products or services via the Internet. This volatility has been coupled with record trading volume in many of these stocks, which are primarily listed on Nasdaq. Customers eager to trade Internet and technology stocks have flooded their brokers and, consequently, market makers such as us with larger numbers of orders, leading to large order imbalances, systems queues and backlogs. During these extreme market conditions, many firms have implemented procedures that are designed to preserve the continuous execution of customers' orders while also lessening the exposure of the firm to extraordinary market risk.

In the fourth quarter of 1998, we modified our execution policies in response to these changes in the marketplace. Our current policy is to provide continuous automatic execution on orders of up to 2,000 shares for investors in over 3,400 Nasdaq stocks under normal market conditions. We reserve the right at our sole discretion to reduce, modify, suspend or cancel any of our guaranteed or automated order handling protocols, including automated price improvement and automatic execution, without prior notice on a stock by stock or client by client basis, when periods of extreme or unusual market conditions exist, risk management protocols so dictate, attempts are made to circumvent our automated execution size limitations, or we otherwise deem it appropriate.

In the normal course of our options market-making business, we maintain inventories of options, futures and equities. Our main exposures are from equity price and volatility risk. We manage these exposures by constantly monitoring and diversifying our exposures and position sizes and establishing offsetting hedges. Our market-making staff and trading room managers continuously manage our positions and our risk exposures. Our systems incorporate trades and update our risk profile using options pricing models on a real time basis.

Our proprietary options risk management system allows us to stress test our portfolio on a real-time basis. On a daily basis, risk reports are distributed to senior management and the firm's risk managers who incorporate this information in our daily market-making decisions. These reports identify potential exposures in terms of options and futures on individual securities and index contracts, organized in different ways such as industry sectors, under extreme price and volatility movements. At December 31, 2000, 10% movements in volatility and stock prices on our entire equity options and equity index option portfolios, which contain the majority of our market risk, would have resulted in approximately the following gains (losses) in our options market-making portfolio:

Options Market-Making

Change in Stock Prices		
-10%	None	+10%

Change in Volatility			
+10%	$1.6 million	($0.2 million)	$5.3 million
None	1.9 million	--	4.7 million
-10%	2.4 million	0.6 million	4.4 million

For working capital purposes, we invest in money market funds, commercial paper, government securities or maintain interest-bearing balances in our trading accounts with clearing brokers, which are classified as cash equivalents and receivable from clearing brokers, respectively, in the Consolidated Statements of Financial Condition. These other amounts do not have maturity dates or present a material market risk, as the balances are short-term in nature and subject to daily repricing.

Consolidated Quarterly Results (unaudited)

The following table sets forth certain unaudited consolidated quarterly statement of income data and certain unaudited consolidated quarterly operating data for the years ended December 31, 2000 and 1999. In the opinion of our management, this unaudited information has been prepared on substantially the same basis as the consolidated financial statements appearing elsewhere in this annual report and includes all adjustments (consisting of normal recurring adjustments) necessary to present fairly the unaudited consolidated quarterly data. The unaudited consolidated quarterly data should be read in conjunction with the audited consolidated financial statements and notes thereto appearing elsewhere in this annual report. The results of any quarter are not necessarily indicative of results for any future period.

	Quarter Ended					
	Dec. 31, 2000	Sept. 30, 2000	June 30, 2000	Mar. 31, 2000	Dec. 31, 1999	Sept 19
	(in thousands)					
Revenues						
Net trading revenue	$223,116	$165,106	$282,515	$486,778	$267,636	$14
Asset management fees	10,857	10,013	11,241	9,774	4,187	
Interest and dividends, net of interest expense	2,865	5,653	4,112	3,507	4,918	
Commissions and fees	13,255	5,877	5,998	7,028	4,751	
Investment income and other	1,235	1,216	3,262	3,512	206	
Total revenues	251,328	187,865	307,128	510,599	281,698	16
Expenses						
Employee compensation and benefits/pro forma employee compensation and benefits(1)	86,377	57,308	102,286	175,466	88,569	4
Payments for order flow	39,738	37,270	38,319	59,318	39,846	3
Execution and clearance fees	28,623	24,476	28,917	30,222	25,301	2
Communications and data processing	10,737	8,057	7,105	7,126	5,349	
Depreciation and amortization	8,244	7,375	5,501	4,215	3,445	
Professional fees	5,043	5,844	6,107	4,532	2,785	
Occupancy and equipment rentals	5,930	5,405	4,314	3,093	3,239	
Business development	4,245	2,438	2,884	5,239	4,226	

Merger related costs......................	--	--	--	--	9,969	
Other.....................................	4,824	5,168	2,304	4,606	1,474	
Total expenses............................	193,761	153,341	197,737	293,817	184,203	11
Income before income taxes and minority interest..................................	57,567	34,524	109,391	216,782	97,495	4
Income tax expense/pro forma income tax expense(2)................................	22,976	14,110	41,906	81,098	37,216	1
Income before minority interest.............	34,591	20,414	67,485	135,684	60,279	2
Minority interst in consolidated subsidiaries	(659)	(178)	--	--	--	
Net income / pro forma net income...........	$ 35,250	$ 20,592	$ 67,485	$135,684	$ 60,279	$ 2
Other Operating Data						
Total equity shares traded (in millions).....	24,797	21,922	21,517	43,817	25,947	1
Total equity trades executed................	33,957	31,419	33,285	44,069	30,112	2
Average daily equity trades.................	539	499	528	700	470	
Average daily net equities trading revenues..	$ 2,905	$ 2,269	$ 3,893	$ 7,209	$ 3,860	$
Total U.S. option contracts executed.........	8,250	5,131	4,473	3,527	3,382	

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(1) Before the merger, Arbitrade was a limited liability company and compensation and benefits to Arbitrade's members was accounted for as distributions of members' equity. Pro forma compensation expense was computed as 15% of the before-tax profits earned by Arbitrade for the quarters ended March 31, 1999, June 30, 1999, September 30, 1999 and December 31, 1999 and for the period ended January 12, 2000, the date of the merger.

(2) Before our merger with KFP, KFP was a limited liability company and was not subject to income taxes. For the quarters ended March 31, 1999 and June 30, 1999, September 30, 1999 and December 31, 1999, pro forma income taxes were computed based on an effective tax rate of 42.5%. Of the $81,098 in income taxes for the quarter ended March 31, 2000, $643 represents pro forma income taxes for the period from January 1, 2000 through January 12, 2000, and $80,455 represents actual income taxes for the period from January 13, 2000 through March 31, 2000. The income tax amounts for subsequent quarters represent actual income taxes. See Note 15 of the Notes to Consolidated Financial Statements.

Item 8. Financial Statements and Supplementary Data

KNIGHT TRADING GROUP, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of
Knight Trading Group, Inc.

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of income, of changes in stockholders' (members') equity and of cash flows present fairly, in all material respects, the financial position of Knight Trading Group, Inc. and its subsidiaries at December 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

PRICEWATERHOUSECOOPERS LLP

New York, New York
January 17, 2001

KNIGHT TRADING GROUP, INC.

CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION

	December 31, 2000	Decembe 199
Assets		
Cash and cash equivalents	$ 364,057,534	$ 304,0
Securities owned, held at clearing broker, at market value	1,799,966,679	910,2
Receivable from brokers and dealers	114,047,275	215,4
Fixed assets and leasehold improvements at cost, less accumulated depreciation and amortization of $34,969,580 in 2000 and $16,297,660 in 1999	79,014,393	26,8
Goodwill, less accumulated amortization of $15,569,227 in 2000 and $10,190,634 in 1999	45,239,177	24,8
Investments	64,917,975	40,4
Other assets	54,166,139	18,4
Total assets	$2,521,409,172	$1,540,2
Liabilities and Stockholders' Equity		
Liabilities		

Securities sold, not yet purchased, at market value	$1,427,214,323	$ 720,9
Securities sold under agreements to repurchase	--	10,4
Payable to brokers and dealers	184,269,478	159,9
Accrued compensation expense	62,444,645	57,2
Accrued execution and clearance fees	6,092,754	8,3
Accrued payments for order flow	11,635,069	13,9
Accounts payable, accrued expenses and other liabilities	30,576,814	54,2
Income taxes payable	4,813,771	15,9
Total liabilities	1,727,046,854	1,041,0
Minority interest in consolidated subsidiaries	20,175,872	
Commitments and contingent liabilities (Notes 12 and 17)		
Stockholders' equity		
Class A Common Stock, $0.01 par value, 500,000,000 shares authorized; 123,290,780 shares issued and outstanding at December 31, 2000 and 122,121,474 shares issued and outstanding at December 31, 1999	1,232,908	1,2
Additional paid-in capital	309,611,248	291,9
Retained earnings	465,947,294	206,0
Accumulated other comprehensive income (loss)--foreign currency translation adjustments, net of tax	(2,605,004)	
Total stockholders' equity	774,186,446	499,2
Total liabilities and stockholders' equity	$2,521,409,172	$1,540,2

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

31

KNIGHT TRADING GROUP, INC.

CONSOLIDATED STATEMENTS OF INCOME

	For the years ended December 31,		
	2000	1999	1998
Revenues			
Net trading revenue	$1,157,515,897	$845,105,365	$395,416,547
Asset management fees	41,883,882	19,921,092	6,134,265
Interest and dividends, net of interest expense	16,137,298	11,949,821	3,980,751
Commissions and fees	32,157,736	16,439,090	3,983,133
Investment income and other	9,224,764	3,160,075	1,519,936
Total revenues	1,256,919,577	896,575,443	411,034,632
Expenses			
Employee compensation and benefits	421,169,673	269,223,837	123,022,795
Payments for order flow	174,645,439	138,696,691	82,499,233
Execution and clearance fees	112,238,423	89,575,394	50,724,104
Communications and data processing	33,025,036	18,944,361	11,720,959
Depreciation and amortization	25,335,639	11,395,735	7,271,384

Professional fees	21,526,495	7,889,198	4,512,724
Occupancy and equipment rentals	18,741,887	10,706,397	6,138,502
Business development	14,806,302	10,294,545	2,913,170
Merger related costs	--	9,969,295	--
Interest on Preferred Units	--	--	714,904
Other	16,899,239	7,050,073	3,435,191
Total expenses	838,388,133	573,745,526	292,952,966
Income before income taxes and minority interest	418,531,444	322,829,917	118,081,666
Income tax expense	159,446,394	111,545,941	22,251,209
Income before minority interest	259,085,050	211,283,976	95,830,457
Minority interest in consolidated subsidiaries	836,952	--	--
Net income	$ 259,922,002	$211,283,976	$ 95,830,457
Basic earnings per share	$ 2.12	$ 1.75	$ 0.93
Diluted earnings per share	$ 2.05	$ 1.68	$ 0.93
Shares used in basic earnings per share (see Note 13)	122,520,733	120,821,710	103,115,712
Shares used in diluted earnings per share (see Note 13)	126,863,316	125,755,430	103,115,712

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

32

KNIGHT TRADING GROUP, INC.

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' (MEMBERS') EQUITY

For the Years Ended December 31, 1998, 1999 and 2000

	Roundtable Partners, L.L.		
	Common Units		
	Units	Amount	Undist Inc
Balance January 1, 1998	734,497	$ 7,344,970	$ 46,6
Distributions on Common Units	--	--	(57,2
Net income for the period from January 1, 1998 through July 12, 1998 (see Notes 2 and 3)	--	--	36,7
Reorganization, July 13, 1998 (see Notes 2 and 3)	(734,497)	(7,344,970)	(26,1
Exercise of option by Brown and Company	--	--	
Net proceeds from initial public offering	--	--	
Issuance of restricted stock to directors	--	--	
Adjustment for pooling of interests with Arbitrade Holdings, L.L.C.	--	--	
Balance at July 13, 1998, as restated	--	--	
Capital distributions to members' of pooled entity	--	--	
Net income for the period from July 13, 1998 through December 31,			

1998 (including pooled entity)	--	--	
Balance December 31, 1998	--	--	
Net income	--	--	
Translation adjustment arising during period, net of taxes	--	--	
Total comprehensive income			
Net proceeds from stock offering	--	--	
Conversion of Class B Common Stock into Class A Common Stock	--	--	
Capital contributions from members of pooled entity	--	--	
Capital distributions to members of pooled entity	--	--	
Stock options exercised	--	--	
Income tax benefit--stock options exercised	--	--	
Balance, December 31, 1999	--	--	
Net income	--	--	
Translation adjustment arising during period, net of taxes	--	--	
Total comprehensive income			
Stock options exercised	--	--	
Income tax benefit--stock options exercised	--	--	
Balance, December 31, 2000	--	$ --	$

	Class B Common Stock Shares	Class B Common Stock Amount	Additi Paid Capi
Balance January 1, 1998	--	$ --	$
Distributions on Common Units	--	--	
Net income for the period from January 1, 1998 through July 12, 1998 (see Notes 2 and 3)	--	--	
Reorganization, July 13, 1998 (see Notes 2 and 3)	7,885,396	78,854	32,65
Exercise of option by Brown and Company	--	--	6
Net proceeds from initial public offering	--	--	136,31
Issuance of restricted stock to directors	--	--	21
Adjustment for pooling of interests with Arbitrade Holdings, L.L.C.	--	--	14,13
Balance at July 13, 1998, as restated	7,885,396	78,854	183,38
Capital distributions to members' of pooled entity	--	--	(8,47
Net income for the period from July 13, 1998 through December 31, 1998 (including pooled entity)	--	--	
Balance December 31, 1998	7,885,396	78,854	174,90
Net income	--	--	
Translation adjustment arising during period, net of taxes	--	--	
Total comprehensive income			
Net proceeds from stock offering	--	--	80,17
Conversion of Class B Common Stock into Class A Common Stock	(7,885,396)	(78,854)	
Capital contributions from members of pooled entity	--	--	21,10
Capital distributions to members of pooled entity	--	--	
Stock options exercised	--	--	5,47
Income tax benefit--stock options exercised	--	--	10,31

Balance, December 31, 1999	--	--	291,96
Net income	--	--	
Translation adjustment arising during period, net of taxes	--	--	
Total comprehensive income			
Stock options exercised	--	--	8,64
Income tax benefit--stock options exercised	--	--	8,99
Balance, December 31, 2000	--	$ --	$309,61

	Accumulated Other Comprehensive Income	Total
Balance January 1, 1998	$ --	$ 53,973,461
Distributions on Common Units	--	(57,265,529)
Net income for the period from January 1, 1998 through July 12, 1998 (see Notes 2 and 3)	--	36,790,346
Reorganization, July 13, 1998 (see Notes 2 and 3)	--	--
Exercise of option by Brown and Company	--	71,430
Net proceeds from initial public offering	--	136,522,770
Issuance of restricted stock to directors	--	217,500
Adjustment for pooling of interests with Arbitrade Holdings, L.L.C.	--	14,236,216
Balance at July 13, 1998, as restated	--	184,546,194
Capital distributions to members' of pooled entity	--	(37,704,287)
Net income for the period from July 13, 1998 through December 31, 1998 (including pooled entity)	--	59,040,111
Balance December 31, 1998	--	205,882,018
Net income	--	211,283,976
Translation adjustment arising during period, net of taxes	17,574	17,574
Total comprehensive income		211,301,550
Net proceeds from stock offering	--	80,219,537
Conversion of Class B Common Stock into Class A Common Stock	--	--
Capital contributions from members of pooled entity	--	21,100,568
Capital distributions to members of pooled entity	--	(35,069,365)
Stock options exercised	--	5,485,202
Income tax benefit--stock options exercised	--	10,311,592
Balance, December 31, 1999	17,574	499,231,102
Net income	--	259,922,002
Translation adjustment arising during period, net of taxes	(2,622,578)	(2,622,578)
Total comprehensive income		257,299,424
Stock options exercised	--	8,656,997
Income tax benefit--stock options exercised	--	8,998,923
Balance, December 31, 2000	$(2,605,004)	$774,186,446

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

Knight Trading Group, Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the ye
	2000
Cash flows from operating activities	
Net income	$ 259,922,002
Adjustments to reconcile net income to net cash provided by operating activities	
Income tax credit from stock options exercised	8,998,923
Issuance of restricted stock to Directors	--
Depreciation and amortization	25,335,639
Minority interest in earnings of consolidated subsidiary	(836,952)
(Increase) decrease in operating assets	
Securities owned	(889,733,763)
Receivable from clearing brokers	101,375,933
Other assets	(38,341,170)
Increase (decrease) in operating liabilities	
Securities sold, not yet purchased	706,295,310
Securities sold under agreements to repurchase	(10,409,736)
Payable to clearing broker	24,326,460
Accrued compensation expense	5,210,037
Accounts payable, accrued expenses and other liabilities	(23,628,668)
Accrued execution and clearance fees	(2,278,302)
Accrued payments for order flow	(2,343,785)
Income taxes payable	(11,179,166)
Interest payable on Preferred Units	--
Net cash provided by operating activities	152,712,762
Cash flows from investing activities	
Purchases of fixed assets and leasehold improvements	(71,031,773)
Investments and acquisitions	(45,061,927)
Payment of contingent consideration	(6,284,903)
Net cash used in investing activities	(122,378,603)
Cash flows from financing activities	
Proceeds from short term loan	--
Repayment of short term loan	--
Net proceeds from initial public offering	--
Net proceeds from exercise of Brown option	--
Repayment of subordinated loan	--
Proceeds from issuance of common stock	--
Stock options exercised	8,656,997
Minority interest in consolidated subsidiary	21,012,824
Loans to members	--
Repayments of loans to members	--
Redemptions of Mandatorily Redeemable Preferred A Units	--
Redemptions of Mandatorily Redeemable Preferred B Units	--
Distributions on Common Units	--
Redemptions by members of KFP	--
Capital distributions to members of KFP	--

Net cash provided by financing activities	29,669,821	
Increase in cash and cash equivalents	60,003,980	
Cash and cash equivalents at beginning of period	304,053,554	
Cash and cash equivalents at end of period	$ 364,057,534	$
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 40,643,281	$
Cash paid for income taxes	$ 175,180,680	$

Supplemental information pertaining to noncash investing and financing activities:
During April 1998, the Company terminated a capital lease with a remaining obligation of $713,207. The net book value of the equipment under such capital lease was $619,747.
During 1999, all outstanding shares of Class B Common Stock were converted into shares of Class A Common Stock.

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

KNIGHT TRADING GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Organization and Description of the Business

Knight Trading Group, Inc. (the "Company") and its subsidiaries operate in market-making and asset management business lines. Knight Securities ("KS") operates as a market maker in over-the-counter equity securities ("OTC securities"), primarily those traded in the Nasdaq stock market and on the OTC Bulletin Board. Knight Capital Markets ("KCM," formerly known as Trimark Securities) operates as a market maker in the over-the-counter market for New York Stock Exchange (NYSE)--and American Stock Exchange (AMEX)--listed securities. Knight Financial Products ("KFP") makes markets in options on individual equities, equity indices and fixed income instruments in the U.S. and Europe. The Company also maintains an asset management business for institutional investors and high net worth individuals through its Deephaven Capital Management ("Deephaven") subsidiary. KS, KCM and KFP are registered as broker-dealers with the Securities and Exchange Commission ("SEC" or the "Commission"). Additionally, KS and KCM are members of the National Association of Securities Dealers, Inc. ("NASD"). Knight Securities International, Ltd. ("KSIL") provides best execution solutions for European investors in pan-European and U.S. equities. In the third quarter of 2000 the Company established a joint venture operation, called Knight Securities Japan ("KSJ") with Nikko Securities Co., Ltd. to provide wholesale market-making services in Japanese equity securities. During the year, the Company purchased the professional execution services business from Mesirow Financial, which was subsequently renamed Knight Execution Partners ("KEP").

The Company was organized in January 2000 as the successor to the business of its predecessor,
Knight /Trimark Group, Inc. (the "Predecessor") (see below). The Predecessor was organized in April 1998 as the successor to the business of Roundtable

Partners, L.L.C. ("Roundtable"). In May 2000, the Company changed its name from Knight /Trimark Group, Inc. to Knight Trading Group, Inc.

On January 12, 2000, the Company completed a merger (the "Merger") with Arbitrade Holdings LLC ("Arbitrade"). The transaction resulted in the Company, a newly formed parent holding company, issuing shares on a tax-free basis to holders of the Predecessor's common stock and to the owners of Arbitrade. Following the transaction, the Predecessor and Arbitrade became subsidiaries of the Company, which assumed the name Knight /Trimark Group, Inc. and became the publicly traded Nasdaq company under the same ticker symbol as the Predecessor (NITE). Arbitrade's options market-making unit subsequently changed its name to Knight Financial Products. The transaction was accounted for as a pooling of interest and, as such, the historical financial statements have been restated to account for the merger on a retroactive basis. The foregoing brief summary is qualified in its entirety by reference to the Merger Agreement, a copy of which was filed as an exhibit to the Company's report on Form 8-K filed with the SEC on January 12, 2000. Unless otherwise indicated, all references to the "Company" refer to the Company or the Predecessor, as appropriate.

2. Roundtable Partners, L.L.C.

Roundtable was organized in March 1995 to own and operate the securities market-making businesses of the predecessors to KS and KCM, respectively. Roundtable was owned 40% by key employees (the "Management Investors") and 60% by a consortium of independent securities firms and investors (the "Non-Management Investors"). Certain Management Investors also received Mandatorily Redeemable Preferred B Units (the "Preferred B Units") of Roundtable in consideration for the contribution of their business to Roundtable, while the Non-Management Investors received Mandatorily Redeemable Preferred A Units (the "Preferred A Units") in return for cash consideration in a ratio of six Preferred A Units to one Common Unit. In connection with a reorganization and initial public offering of the Company's Common Stock (the "initial public offering") on July 13, 1998, the owners of Roundtable elected to exchange their membership interests in Roundtable for shares of Common Stock of the Company (see Note 3). Additionally, the Preferred A and B Units were redeemed and retired in their entirety. All redemptions were made at book value.

3. Reorganization, Public Stock Offerings and Stock Split

Concurrent with the closing of the initial public offering of the Company's Common Stock on July 13, 1998, based on the initial public offering price of $7.25 per share, all of the member interests of Roundtable were

exchanged for 73,324,830 shares of Class A Common Stock of the Company and 7,885,396 shares of nonvoting Class B Common Stock of the Company (the "Reorganization").

The initial public offering of 23,000,000 shares of Class A Stock included 20,376,492 newly-issued shares and 2,623,508 shares from a selling shareholder. Proceeds received by the Company from the initial public offering, net of the applicable underwriting discounts and commissions and offering expenses, were approximately $136.5 million.

On February 25, 1999, the Company sold 20,700,000 shares of Class A Common Stock at a price to the public of $17.50 per share. Of those shares, 4,849,440 were sold by Knight/Trimark, generating net offering proceeds, after deducting underwriting discounts and commissions and offering expenses, of approximately $80.2 million. An additional 15,850,560 shares were sold by selling shareholders.

In April 1999, the Company's Board of Directors approved a two-for-one stock split of the Company's Class A and Class B Common Stock. Shareholders of record as of the close of business on April 30, 1999 received, in the form of a stock dividend, one additional share for each share held by them. On May 14, 1999, the transfer agent distributed the additional shares. All share and per share amounts presented in this document have been adjusted to reflect the stock split.

In connection with the Merger, the Company issued 10,505,001 shares of Class A Common Stock to the former shareholders of Arbitrade.

4. Significant Accounting Policies

Basis of consolidation and form of presentation

The accompanying consolidated financial statements include the accounts of the Company and its majority and wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated.

Cash equivalents

Cash equivalents represent money market accounts, which are payable on demand, or short-term investments with an original maturity of less than 30 days. The carrying amount of such cash equivalents approximates their fair value due to the short-term nature of these instruments.

Investments

Investments on the Consolidated Statements of Financial Condition comprise ownership interests of less than 20% in publicly and non-publicly traded companies which are accounted for under the equity method or the cost basis of accounting. Investments also include the Company's investments in private investment funds for which the Company is the investment manager and sponsor.

Market-making activities

Securities owned and securities sold, not yet purchased, which primarily consist of listed and OTC stocks, listed options contracts and futures contracts are carried at market value and are recorded on a trade date basis. Net trading revenue (trading gains, net of trading losses) and commissions and related expenses, including compensation and benefits, execution and clearance fees and payments for order flow, are also recorded on a trade date basis. Payments for order flow represent payments to other broker-dealers for directing their order executions to the Company. The Company records interest income net of transaction-related interest charged by clearing brokers for facilitating the settlement and financing of securities transactions, and interest expense on subordinated notes and short-term debt. Interest expense incurred during 2000 and 1999 amounted to approximately $40.9 million and $11.9 million, respectively.

Asset management fees

The Company earns asset management fees for sponsoring and managing the investments of certain private investment funds. Such fees are recorded when earned and are calculated as a percentage of the fund's quarterly net assets, plus a percentage of a new high net asset value, as defined, for any six-month period ended June 30/th/ or December 31/st/.

Mandatorily redeemable preferred units

The Preferred A and Preferred B Units were mandatorily redeemable and the distributions on such units have been classified as interest expense in the Consolidated Statements of Income.

Securities borrowed/loaned

Securities borrowed and securities loaned are recorded at the amount of cash collateral advanced or received. Securities borrowed transactions require the Company to deposit cash or similar collateral with the lender. With respect to securities loaned, the Company receives collateral in the form of cash in an amount generally in excess of the market value of securities loaned. Interest income and interest expense are recorded on an accrual basis. The Company monitors the market value of securities borrowed and loaned on a daily basis. Substantially all of the Company's securities borrowed and securities loaned transactions are conducted with banks and other securities firms.

Foreign Currencies

The functional currency of the Company's consolidated foreign subsidiaries are the U.S. dollar, the British Pound and the Japanese Yen. Assets and liabilities in foreign currencies are translated into U.S. dollars using current exchange rates at the date of the Consolidated Statements of Financial Condition. Revenues and expenses are translated at average rates during the periods. The foreign exchange gains and losses resulting from these translations are included as a separate component of stockholders' equity in the Consolidated Statements of Financial Condition.

Depreciation, amortization and occupancy

Fixed assets are being depreciated on a straight-line basis over their estimated useful lives of three to seven years. Leasehold improvements are being amortized on a straight-line basis over the life of the related office lease. The Company records rent expense on a straight-line basis over the life of the lease. The Company capitalizes certain costs associated with the acquisition or development of internal-use software in accordance with Statement of Position No. 98-1 and amortizes the software over its estimated useful life of three years.

Income taxes

Income tax expense in the Consolidated Statements of Income represents income taxes incurred from July 13, 1998, the date of the Reorganization, through December 31, 1998 and for the years ended December 31, 1999 and 2000. Before the Reorganization, Roundtable was a limited liability company and was not subject to federal

KNIGHT TRADING GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

or state income taxes. Subsequent to the Reorganization, the Company is subject to federal income taxes and state income taxes. Before the Merger, KFP was a limited liability company which was treated as a partnership for tax purposes and its federal and state income taxes were borne by KFP's individual partners. As such, KFP's historical financial statements only include a provision for non-U.S. income taxes. Subsequent to the Merger, KFP's income is subject to federal and state income taxes.

The Company records deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse.

Estimated fair value of financial instruments

The Company's securities owned and securities sold, not yet purchased are carried at market value. Management estimates that the fair values of other financial instruments recognized on the Consolidated Statements of Financial Condition (including receivables, payables, accrued expenses, subordinated debt and mandatorily redeemable preferred units) approximate their carrying values, as such financial instruments are short-term in nature, bear interest at current market rates or are subject to frequent repricing.

Minority interest

Minority interest represents a minority owner's share of net income or equity in one of the Company's consolidated subsidiaries.

Other

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Certain prior year amounts have been reclassified to conform to the current year presentation.

5. Securities Owned and Securities Sold, Not Yet Purchased

Securities owned and securities sold, not yet purchased consist of the following:

	December 31, 2000	December 31, 1999
Securities owned:		
Equities.......................	$ 661,327,729	$381,240,123
Options........................	1,126,483,498	518,408,094
U.S. government obligations.....	12,155,452	10,584,699
	$1,799,966,679	$910,232,916

Securities sold, not yet purchased:		
Equities	$ 170,167,713	$263,614,076
Options	1,257,046,610	457,304,937
	$1,427,214,323	$720,919,013

6. Receivable from/Payable to Brokers and Dealers

At December 31, 2000, amounts receivable from and payable to brokers and dealers consist of the following:

Receivable:	
Clearing brokers	$ 86,156,298
Securities failed to deliver	19,815,796
Securities borrowed	8,075,181
	$114,047,275
Payable:	
Clearing brokers	$175,552,245
Securities failed to receive	8,574,981
Securities loaned	142,252
	$184,269,478

The Company had received and pledged collateral approximately equal to the amounts borrowed and loaned, respectively.

7. Investments

The Company's wholly-owned subsidiary, Deephaven, is the investment manager and sponsor of private investment funds that engage in various trading strategies involving equities, debt instruments and derivatives. The Company owns interests in these private investment funds. Such investments amounted to approximately $13.9 million at December 31, 2000. Certain officers of the Company also own interests in these private investment funds. Additionally, the Company has made strategic investments in the National Association of Securities Dealers, Inc., Easdaq, Netfolio, Inc. and other public and private companies.

8. Significant Customers

Before the Reorganization and initial public offering, Roundtable was owned by a consortium of independent securities firms and investors (the "Broker Dealer Owners"). Under Roundtable's limited liability company agreement, the Broker Dealer Owners, who were considered affiliated companies, shared in

Roundtable's profits in proportion to their equity interests and the quantity of order flow they directed to the Company. After the initial public offering, this profit sharing practice was discontinued. Subsequent to the initial public offering, the Company considers affiliates to be holders of 10% or more of the Company's outstanding common stock ("Affiliates"). During 2000 there were no Affiliates of the Company.

One customer provided 11.6% of the Company's equity order flow for the year ended December 31, 2000 as measured in equity share volume. Rebates paid to this firm for equity share and options contract volume amounted to $23,283,345 during the same period.

9. Goodwill

The Company's acquisition of the business of Trimark Securities, L.P. during 1995 was recorded under the purchase method and the carrying values of the assets and liabilities acquired were adjusted to their fair market values as of the acquisition date. The excess of the purchase price over the fair value of the net assets acquired of $13,960,195 was recorded as goodwill and is being amortized over a period of 10 years. In connection with the acquisition, the Company entered into an agreement which entitled the former owners to receive additional consideration during the five years immediately subsequent to the acquisition, through March 2000, equal to 10%

of Trimark's pre-tax earnings, before amortization of goodwill and depreciation on fixed assets initially purchased. All amounts paid under this arrangement have been capitalized as additional purchase price (goodwill) and are being amortized over the remainder of the original ten-year amortization period.

Pursuant to an agreement effective November 17, 1997, Trimark purchased the business and the related fixed assets of Tradetech Securities, L.P. ("Tradetech"), an Illinois Limited Partnership, in exchange for $750,000 in cash and contingent consideration. Tradetech was a direct competitor of Trimark operating as a market maker in listed stocks and, after the acquisition, its business and operations were integrated into Trimark's. The acquisition was accounted for under the purchase method and the carrying values of the assets acquired were adjusted to their fair market values as of the acquisition date. The excess of the purchase price over the fair value of the assets acquired of $400,000 was recorded as goodwill and is being amortized over a period of five years.

In connection with the acquisition, Trimark entered into an agreement with Tradetech which entitled Tradetech to additional consideration equal to 10% of Trimark's pretax earnings during the period from the acquisition date through December 31, 2000 (the "Earnout Period"). All amounts paid under this arrangement have been capitalized as additional purchase price (goodwill) and are being amortized over the remainder of the original five-year amortization period.

The total contingent consideration paid and recorded as goodwill by the Company was as follows:

	Trimark Additional	Tradetech Additional

	Consideration	Consideration	Total
For the year ended December 31, 1998.	$2,155,007	$1,921,889	$4,076,896
For the year ended December 31, 1999.	3,098,161	2,855,058	5,953,219
For the year ended December 31, 2000.	1,757,948	4,526,955	6,284,903

Additionally, consistent with the growth of the Company's options market-making business, KFP has acquired various options related businesses. The total excess of the purchase prices over the fair value of the assets acquired of $26,640,859 was recorded as goodwill and is being amortized over a period of 15 years.

10. Fixed Assets and Leasehold Improvements

Fixed assets and leasehold improvements comprise the following:

	Depreciation Period	December 31, 2000	December 31, 1999
Computer hardware and software................	3 years	$ 81,847,768	$26,958,037
Leasehold improvements........................	Life of Lease	15,183,830	7,948,011
Telephone systems............................	5 years	6,944,133	3,170,016
Furniture and fixtures........................	7 years	6,901,463	2,292,481
Trading systems..............................	5 years	1,613,082	1,425,347
Equipment....................................	5 years	1,493,697	1,323,813
		113,983,973	43,117,705
Less--Accumulated depreciation and amortization		34,969,580	16,297,660
		$ 79,014,393	$26,820,045

11. Short-Term Financing

On June 19, 1998, the Company entered into an unsecured $30.0 million loan agreement with an affiliate of one of its clearing brokers. Such loan paid interest monthly based on the London Interbank Offered Rate and was to mature on June 19, 1999. The loan agreement allowed for scheduled principal pre-payments without penalty. During 1998, the Company made principal pre-payments under the loan of $20.0 million. On January 19, 1999, the Company repaid the final $10.0 million. Interest expense incurred on such loan for the years ended December 31, 1999 and 1998 amounted to $39,734 and $946,752, respectively.

At December 31, 1999, the Company had a $10,000,000 collateralized credit facility with a bank under which it borrowed on a revolving basis. Interest was variable based on prime plus one percent per annum and payable monthly. The

Company paid a one half percent per annum commitment fee on the unused portion of the facility. The unused portion of the facility and interest rate at December 31, 1999 were $7,945,408 and 9.00%, respectively.

12. Commitments and Contingent Liabilities

The Company leases office space under noncancellable operating leases. The office leases contain certain escalation clauses whereby the rental commitments may be increased if certain conditions are satisfied and specify yearly adjustments to the lease amounts based on annual adjustments to the Consumer Price Index. Rental expense under the office leases was as follows:

For the year ended December 31, 1998	$2,000,910
For the year ended December 31, 1999	2,989,873
For the year ended December 31, 2000	7,288,699

Additionally, the Company leases computer and other equipment under noncancellable operating leases. As of December 31, 2000, future minimum rental commitments under all noncancellable operating leases were as follows:

	Office Leases	Other Leases	Total
Year ending December 31, 2001.......	$ 10,477,570	$4,303,393	$ 14,780,963
Year ending December 31, 2002.......	14,927,896	1,899,916	16,827,812
Year ending December 31, 2003.......	14,428,717	325,888	14,754,605
Year ending December 31, 2004.......	12,888,648	255,438	13,144,086
Year ending December 31, 2005.......	11,873,782	--	11,873,782
Thereafter through September 1, 2021	138,250,597	--	138,250,597
	$202,847,210	$6,784,635	$209,631,845

The Company has been named as a defendant in legal actions. In addition, from time to time, the Company is a party to examinations and inquiries by various regulatory and self-regulatory bodies. In the opinion of management, based on consultation with legal counsel, any adverse outcome with regard to these matters would not likely have a material adverse effect on the results of operations or the financial position of the Company.

13. Earnings per Share

Basic and diluted earnings per common share have been calculated by dividing net income by the sum of the weighted average shares of Class A Common Stock and Class B Common Stock outstanding during each respective period. Except for voting rights, the Class B Common Stock had identical rights and rewards as the Class A Common Stock and was automatically converted to Class A Common Stock in the event of a sale or a transfer by the owner. All outstanding shares of Class B Common Stock were converted into shares of Class A Common Stock during 1999.

Weighted-average shares outstanding for the year ended December 31, 1998 has been determined as if the Merger described in Note 1 and the Reorganization described in Note 3 occurred as of the earliest date presented. Weighted-average shares outstanding for the years ended December 31, 1999 and 2000 have been determined as if the Merger described in Note 1 occurred as of the earliest date presented. For the year ended December 31, 1998 the Company's outstanding options did not have a dilutive effect on earnings and, as such, do not affect the calculation. The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the years ended December 31, 2000, 1999 and 1998:

	For the year ended December 31,				
	2000		1999		
	Numerator / net income	Denominator / shares	Numerator / net income	Denominator / shares	Numerator net incom
Income and shares used in basic calculations....................	$259,922,002	122,520,733	$211,283,976	120,821,710	$95,830,4
Effect of dilutive stock options.	--	4,342,583	--	4,933,720	
Income and shares used in diluted calculations....................	$259,922,002	126,863,316	$211,283,976	125,755,430	$95,830,4
Basic earnings per share.........		$ 2.12		$ 1.75	
Diluted earnings per share.......		$ 2.05		$ 1.68	

14. Employee Benefit Plan

The Company sponsors 401(k) profit sharing plans (the "Plans") in which substantially all of its employees are eligible to participate. Under the terms of the Plans, the Company is required to make annual contributions to the Plans equal to 50% of the contributions made by its employees, up to certain limitations. The total expense recognized with respect to the Plans was as follows:

For the year ended December 31, 1998	$1,191,907
For the year ended December 31, 1999	1,838,036
For the year ended December 31, 2000	2,856,197

15. Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return. Before the Reorganization, Roundtable was treated as a partnership for tax purposes and its federal and state income taxes were borne by its partners. Subsequent to the Reorganization, the Company is subject to federal and state income taxes. Actual income tax expense on the Consolidated Statements of Income for the year ended December 31, 1998 represents income taxes incurred from July 13, 1998, the date of the Reorganization, through December 31, 1998. Before the Merger, KFP was treated as a partnership for U.S. tax purposes and its federal and state income taxes were borne by KFP's individual partners. As such, KFP's historical financial statements only include a provision for non-U.S. income taxes.

The provision for income taxes consists of:

	2000	1999	1998
Current:			
U.S. federal.....................	$145,441,308	$ 95,344,483	$17,770,620
U.S. state and local and non-U.S..	18,560,206	18,498,299	4,480,589
	164,001,514	113,842,782	22,251,209

	2000	1999	1998
Deferred:			
U.S. federal.....................	(4,119,805)	(1,845,141)	-
U.S. state and local and non-U.S..	(435,315)	(451,700)	-
	(4,555,120)	(2,296,841)	-
Provision for income taxes...........	$159,446,394	$111,545,941	$22,251,209

The following table reconciles the provision to the U.S. federal statutory income tax rate:

	2000	1999	1998
U.S. federal statutory income tax rate............................	35.0%	35.0%	35.0%
U.S. state and local income and non-U.S. taxes, net of U.S. federal income tax benefits..	2.8	4.2	6.0
Other, net..	0.3	0.7	2.2
Effective income tax rate..	38.1%	39.9%	43.2%

Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. Significant components of the Company's deferred tax assets and liabilities at December 31, 2000 and 1999 are as follows:

	2000	1999
Deferred tax assets:		
Employee compensation and benefit plans...	$5,709,498	$1,964,276
Fixed assets and other amortizable assets.	1,720,333	332,567
Total deferred tax assets............	7,429,831	2,296,843
Deferred tax liabilities:		
Valuation of investments.................	564,428	-
Other....................................	13,440	-
Total deferred tax liabilities..............	577,868	-
Net deferred tax assets.....................	$6,851,963	$2,296,843

16. Long-Term Incentive Plans

In connection with the Reorganization and Offering, the Company established the Knight/Trimark Group, Inc. 1998 Long Term Incentive Plan and the Knight/Trimark Group, Inc. 1998 Nonemployee Director Stock Option Plan (together, the "Plans") to provide long-term incentive compensation to selected employees and directors of Knight Trading Group and its subsidiaries. The Plans are administered by the compensation committee of the Company's Board of Directors, and allow for the grant of options, restricted stock and restricted stock units, as defined by the Plans. Including a stockholder-approved increase in the number of shares reserved under the Plans by 10 million in May 2000, the maximum number of shares of Class A Common Stock reserved for the grant of awards under the Plans is 24,819,000, subject to adjustment. In addition, the Plans limit the number of shares which may be granted to a single individual and the Plans also limit the number of shares of restricted stock which may be awarded.

It is the Company's policy to grant options for the purchase of shares of Class A Common Stock at not less than market value, which the Plans define as the average of the high and low sales prices on the date prior to the grant date. Options vest over a four-year period and expire on the tenth anniversary of the grant date. The Company has the right to fully vest employees in their option grants upon retirement. The following is a reconciliation of option activity for the Plans for the years ended December 31, 2000 and 1999, and a summary of options outstanding and exercisable at December 31, 2000:

	2000 Number of Options	2000 Weighted-Average Exercise Price	1999 Number of Options	1999 Weighted-Average Exercise Price
Outstanding, January 1	10,445,235	$10.74	10,237,000	$ 7.24
Granted at market value	4,275,000	37.52	1,072,000	41.78
Exercised	(1,184,810)	7.31	(757,765)	7.24
Surrendered	(994,250)	16.37	(106,000)	8.36
Outstanding at December 31	12,541,175	$19.77	10,445,235	$10.77
Exercisable at December 31	3,484,050	$ 9.82	1,914,485	$ 7.51
Available for future grants at December 31	10,335,250		3,616,000	
Weighted average fair value of grants during the year (at market value)		$19.87		$21.97

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Outstanding at 12/31/00	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at 12/31/00	Weighted-Average Exercise Price
$ 6.54	130,500	7.80	$ 6.54	55,500	$ 6.54
$ 7.25	7,371,175	7.49	7.25	3,172,675	7.25
$10.75--$33.22	1,286,000	9.20	27.59	111,250	25.07
$33.25--$39.75	434,000	9.30	38.27	3,750	34.99
$39.84--$39.84	2,682,500	9.04	39.84	--	--
$42.91--$73.22	637,000	8.48	54.44	140,875	56.37

In addition, concurrent with the closing of the initial public offering, the Company granted a total of 30,000 restricted shares of Class A Common Stock to certain directors of the Company under the 1998 Non-employee Director Stock Option Plan and recorded compensation expense of $217,500 during 1998 for the fair value of the shares on the date of grant, which has been included in Other Expenses in the Consolidated Statements of Income.

The Company applies Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for its stock option plans. Accordingly, no compensation expense has been recognized for the fair values of the options granted to employees. Had compensation expense for the Company's options been determined based on the fair value at the grant dates in accordance with Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation," the

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Company's net income and earnings per share amounts for the years ended December 31, 1998, 1999 and 2000 would have been as follows:

	2000	1999	1998
Net income, as reported...............	$259,922,002	$211,283,976	$95,830,457
Pro forma net income..................	232,403,643	200,895,647	92,128,633
Basic earnings per share, as reported..	2.12	1.75	.93
Diluted earnings per share, as reported	2.05	1.68	.93
Pro forma basic earnings per share.....	1.90	1.66	.89
Pro forma diluted earnings per share...	1.83	1.60	.89

The fair value of each option granted is estimated as of its respective grant date using the Black-Scholes option-pricing model with the following assumptions:

	2000	1999	1998
Dividend yield..........	0.0%	0.0%	0.0%
Expected volatility.....	70%	70%	44%
Risk-free interest rate.	6.0%	6.0%	5.5%
Expected life (in years)	5	5	5

17. Financial Instruments with Off-Balance Sheet Risk and Concentrations of Credit Risk

As a market maker of OTC and listed stocks and listed options contracts, the majority of the Company's securities transactions are conducted as principal with broker-dealer and institutional counterparties primarily located in the United States. The Company clears all of its securities transactions through clearing brokers on a fully disclosed basis. Accordingly, substantially all of the Company's credit exposures are concentrated with the clearing brokers. The clearing brokers can rehypothecate the securities held. Additionally, pursuant to the terms of the agreement between the Company and the clearing brokers, the clearing brokers have the right to charge the Company for losses that result from a counterparty's failure to fulfill its contractual obligations. The Company's policy is to monitor the credit standing of the clearing brokers and all counterparties with which it conducts business. Additionally, as of December 31, 2000, the Company's credit exposures were concentrated with the clearing brokers and amounted to $114.0 million. As of December 31, 2000, the clearing brokers also held, as custodians, securities and options owned by the Company with a market value of $1.8 billion.

Securities sold, not yet purchased represent obligations to purchase such securities at a future date. The Company may incur a loss if the market value of the securities subsequently increases.

Derivative contracts are financial instruments whose value is based upon underlying asset, index, reference rate or a combination of these factors. The Company uses derivative financial instruments as part of its options market-making and trading business and its overall risk management process.

These financial instruments, which generally include exchange-traded options, options on futures and futures contracts, expose the Company to varying degrees of market and credit risk. The Company records its derivative-trading activities at market value, and unrealized gains and losses are recognized currently.

18. Net Capital Requirements

As registered broker-dealers, KS, KCM, KFP and KEP are subject to the SEC's Uniform Net Capital Rule (the "Rule") which requires the maintenance of minimum net capital. KS, KCM and KEP have elected to use the basic method, permitted by the Rule, which requires that they each maintain net capital equal to the greater of $1.0 million or 6 2/3% of aggregate indebtedness, as defined. KFP has elected to use the alternative method, permitted by the Rule, which requires that it maintains net capital equal to the greater of $250,000 or 2% of aggregate debit items, as defined.

At December 31, 2000, KS had net capital of $304,796,340, which was $301,696,970 in excess of its required net capital of $3,099,370, KCM had net capital of $58,251,583, which was $56,828,680 in excess of its required net capital of $1,422,903, KFP had net capital of $32,354,941 which was $32,104,941 in excess of its required net capital of $250,000, and KEP had net capital of $1,439,403 which was $1,146,899 in excess of its required net capital of $292,504.

Additionally,KSIL and KSJ are subject to regulatory requirements in the countries in which they operate, including the requirements of the Securities and Futures Authority Limited in the United Kingdom and the Financial Supervisory Agency in Japan. As of December 31, 2000, the Company was in compliance with these capital adequacy requirements.

19. Business Segments

The Company has two reportable business segments: securities market-making and asset management. Securities market-making primarily includes the operations of KS, KCM and KFP and includes market-making in equity securities listed on Nasdaq, on the OTCBB of the NASD, in the over-the-counter market for NYSE- and AMEX-listed securities and in options on individual equities, equity indices, fixed income instruments and certain commodities. The asset management segment includes the operations of Deephaven Capital Management, Deephaven Capital and Deephaven Investment Advisers and consists of investment management and sponsorship for a series of private investment funds.

The Company's net revenues, income before income taxes and minority interest and assets by segment are summarized below:

	Securities Market Making	Asset Management	Total
For the year ended December 31, 2000:			
Revenues.......................................	$1,210,824,863	$46,094,714	$1,256,919,577

Income before income taxes and minority interest.	383,832,971	34,698,473	418,531,444
Total Assets....................................	2,481,695,369	39,713,803	2,521,409,172
For the year ended December 31, 1999:			
Revenues..	875,667,896	20,907,547	896,575,443
Income before income taxes and minority interest.	306,642,287	16,187,630	322,829,917
Total Assets....................................	1,510,129,050	30,156,756	1,540,285,806
For the year ended December 31, 1998:			
Revenues..	404,705,305	6,329,327	411,034,632
Income before income taxes and minority interest.	115,665,815	2,415,851	118,081,666
Total Assets....................................	675,219,300	9,424,514	684,643,814

20. Condensed Financial Statements of Knight Trading Group, Inc. (parent only)

Presented below are the Condensed Statements of Financial Condition, Income and Cash Flows for the Company on an unconsolidated basis.

Statements of Financial Condition

Knight Trading Group, Inc. (parent only)

	December 31, 2000	December 31, 1999
Assets		
Cash and cash equivalents..............................	$ 25,874,092	$ 99,728,732
Securities owned, at market value......................	12,155,452	--
Investments in subsidiaries, equity method.............	731,643,361	410,554,961
Receivable from subsidiaries...........................	5,883,085	18,450,185
Other assets...	15,578,475	9,106,225
Total assets.......................................	$791,134,465	$537,840,103
Liabilities and Stockholders' Equity		
Liabilities		
Accrued compensation expense...........................	$ 10,361,525	$ 5,858,946
Accounts payable, accrued expenses and other liabilities	2,131,888	15,193,968
Income taxes payable...................................	4,454,606	17,556,087
Total liabilities..................................	16,948,019	38,609,001
Total stockholders' equity.........................	774,186,446	499,231,102
Total liabilities and stockholders' equity..........	$791,134,465	$537,840,103

Statements of Income

Knight Trading Group, Inc. (parent only)

	For the years ended December 31, 2000	1999	1998
Revenues			
Equity in earnings of subsidiaries	$265,900,963	$217,486,596	$102,748,320
Other	2,580,130	3,857,671	266,970
Total revenues	268,481,093	221,344,267	103,015,290
Expenses			
Professional fees	5,562,241	1,850,310	--
Business development	3,193,359	4,779,582	8,123
Merger related costs	--	5,189,295	--
Compensation expense	--	--	1,200,000
Payments for order flow	--	--	1,189,331
Interest on Preferred Units	--	--	714,905
Other	1,064,815	1,161,569	1,716,332
Total expenses	9,820,415	12,980,756	4,828,691
Income before income taxes and minority interest	258,660,678	208,363,511	98,186,599
Income tax (benefit) expense	(1,261,324)	(2,920,465)	2,356,142
Net income	$259,922,002	$211,283,976	$ 95,830,457

KNIGHT TRADING GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Statements of Cash Flows

Knight Trading Group, Inc. (parent only)

	For the yea 2000
Cash flows from operating activities	
Net income	$ 259,922,002
Adjustments to reconcile net income to net cash provided by (used in) operating activities	
Equity earnings of subsidiaries	(265,900,963)
Issuance of restricted stock to directors	--
Income tax credit from stock options exercised	8,998,923
(Increase) decrease in operating assets	
Securities owned	(12,155,452)
Receivable from subsidiaries	12,567,100
Other assets	(6,472,250)
Increase (decrease) in operating liabilities	
Accrued compensation expense	4,502,579

Accounts payable, accrued expenses and other liabilities	(13,062,080)	
Income taxes payable	(13,101,481)	
Interest payable on Preferred Units	--	
Net cash provided by (used in) operating activities	(24,701,622)	
Cash flows from investing activities		
Capital contributions to subsidiaries	(129,810,015)	
Net cash used in investing activities	(129,810,015)	
Cash flows from financing activities		
Proceeds from short term loan	--	
Repayment of short term loan	--	
Repayment of subordinated note	--	
Proceeds from issuance of common stock	--	
Stock options exercised	8,656,997	
Net proceeds from initial public offering	--	
Net proceeds from exercise of Brown option	--	
Dividends received from subsidiaries	72,000,000	
Redemptions of Mandatorily Redeemable Preferred A Units	--	
Redemptions of Mandatorily Redeemable Preferred B Units	--	
Distributions on Common Units	--	
Net cash provided by financing activities	80,656,997	
Increase (decrease) in cash and cash equivalents	(73,854,640)	
Cash and cash equivalents at beginning of period	99,728,732	
Cash and cash equivalents at end of period	$ 25,874,092	$
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 32,718	$
Cash paid for income taxes	$ 175,180,680	$

Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosures

None.

PART III

The Company's Proxy Statement for its 2001 Annual Meeting of Stockholders, which, when filed pursuant to Regulation 14A under the Securities Exchange Act of 1934, will be incorporated by reference in this Annual

48

KNIGHT TRADING GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS--(Continued)

Report on Form 10-K pursuant to General Instruction G(3) of Form 10-K, provides the information required under Part III (Items 10, 11, 12 and 13).

PART IV

Item 14. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) The following documents are filed as part of this report:

Consolidated Financial Statements and Financial Statement Schedules. See "Item 8, Financial Statements and Supplementary Data"

(b) Reports on Form 8-K:

On November 30, 2000, the Company filed a Current Report on Form 8-K to report putative class action lawsuits brought against the Company and current and former officers.

(c) Exhibits

27.1 Financial Data Schedule for the fiscal year ended December 31, 2000

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Jersey City, State of New Jersey, on this 28/th/ day of March, 2001.

KNIGHTTRADING GROUP, INC.

/S/ KENNETH D. PASTERNAK
By: ______________________________________
Kenneth D. Pasternak
Chairman of the Board, President and
Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Registration Statement has been signed by the following persons in the capacities and on the date indicated.

Name	Title	Date
/S/ KENNETH D PASTERNAK ------------------------- Kenneth D. Pasternak	Chairman of the Board, President and Chief Executive Officer	March , 2001
/S/ ROBERT I. TURNER ------------------------- Robert I. Turner	Director, Executive Vice President, Treasurer and Chief Financial Officer (principal financial and accounting officer)	March , 2001
/S/ WALTER F. RAQUET ------------------------- Walter F. Raquet	Director and Executive Vice President	March , 2001
/S/ ANTHONY M. SANFILIPPO ------------------------- Anthony M. Sanfilippo	Director and Executive Vice President	March , 2001
/S/ PETER S. HAJAS ------------------------- Peter Hajas	Director Chief Executive Officer, Knight Financial Products LLC	March , 2001

/S/ JOHN G. HEWITT John Hewitt	Director President, Knight Securities, L.P.	March , 2001
/S/ CHARLES V. DOHERTY Charles V. Doherty	Director	March , 2001
/S/ GARY R. GRIFFITH Gary R. Griffith	Director	March , 2001
/S/ ROBERT GREIFELD Robert Greifeld	Director	March , 2001

50

Name	Title	Date
/S/ BRUCE R. MCMAKEN Bruce R. McMaken	Director	March , 2001
/S/ RODGER O. RINEY Rodger O. Riney	Director	March , 2001
/S/ V. ERIC ROACH V. Eric Roach	Director	March , 2001

51