

Edgar Filing: PIPER JAFFRAY COMPANIES - Form 10-Q

PIPER JAFFRAY COMPANIES  
Form 10-Q  
November 06, 2014

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT  
OF 1934

For the Quarterly Period Ended September 30, 2014

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 001-31720

PIPER JAFFRAY COMPANIES

(Exact Name of Registrant as specified in its Charter)

DELAWARE

30-0168701

(State or Other Jurisdiction of Incorporation or  
Organization)

(IRS Employer Identification No.)

800 Nicollet Mall, Suite 1000

55402

Minneapolis, Minnesota

(Address of Principal Executive Offices)

(Zip Code)

(612) 303-6000

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of October 24, 2014, the registrant had 16,285,976 shares of Common Stock outstanding.



Piper Jaffray Companies  
Index to Quarterly Report on Form 10-Q

PART I. FINANCIAL INFORMATION

ITEM 1.	<u>FINANCIAL STATEMENTS</u>	<u>3</u>
	<u>Consolidated Statements of Financial Condition as of September 30, 2014 (Unaudited) and December 31, 2013</u>	<u>3</u>
	<u>Consolidated Statements of Operations for the three and nine months ended September 30, 2014 and September 30, 2013 (Unaudited)</u>	<u>4</u>
	<u>Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2014 and September 30, 2013 (Unaudited)</u>	<u>6</u>
	<u>Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and September 30, 2013 (Unaudited)</u>	<u>7</u>
	<u>Notes to the Consolidated Financial Statements (Unaudited)</u>	<u>9</u>
ITEM 2.	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	<u>42</u>
ITEM 3.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	<u>71</u>
ITEM 4.	<u>CONTROLS AND PROCEDURES</u>	<u>72</u>

PART II. OTHER INFORMATION

ITEM 1.	<u>LEGAL PROCEEDINGS</u>	<u>72</u>
ITEM 1A.	<u>RISK FACTORS</u>	<u>72</u>
ITEM 2.	<u>UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	<u>72</u>
ITEM 6.	<u>EXHIBITS</u>	<u>73</u>
	<u>SIGNATURES</u>	<u>74</u>

Table of Contents

## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS.

## Piper Jaffray Companies

## Consolidated Statements of Financial Condition

	September 30, 2014	December 31, 2013
(Amounts in thousands, except share data)	(Unaudited)	
Assets		
Cash and cash equivalents	\$ 14,947	\$ 123,683
Cash and cash equivalents segregated for regulatory purposes	38,029	43,012
Receivables:		
Customers	25,669	11,633
Brokers, dealers and clearing organizations	291,190	127,113
Securities purchased under agreements to resell	263,680	167,875
Financial instruments and other inventory positions owned	459,624	406,513
Financial instruments and other inventory positions owned and pledged as collateral	1,023,970	957,515
Total financial instruments and other inventory positions owned	1,483,594	1,364,028
Fixed assets (net of accumulated depreciation and amortization of \$46,128 and \$62,311, respectively)	17,373	16,114
Goodwill	211,878	210,634
Intangible assets (net of accumulated amortization of \$38,823 and \$31,869, respectively)	32,976	39,930
Investments	125,167	112,043
Other assets	96,037	102,092
Total assets	\$ 2,600,540	\$ 2,318,157
Liabilities and Shareholders' Equity		
Short-term financing	\$ 338,795	\$ 514,711
Variable rate senior notes	125,000	125,000
Payables:		
Customers	35,944	33,109
Brokers, dealers and clearing organizations	84,344	27,722
Securities sold under agreements to repurchase	66,973	4,397
Financial instruments and other inventory positions sold, but not yet purchased	768,991	512,833
Accrued compensation	181,322	159,928
Other liabilities and accrued expenses	53,823	58,385
Total liabilities	1,655,192	1,436,085
Shareholders' equity:		
Common stock, \$0.01 par value:		
Shares authorized: 100,000,000 at September 30, 2014 and December 31, 2013;		
Shares issued: 19,523,371 at September 30, 2014 and 19,537,127 at December 31, 2013;		
Shares outstanding: 15,108,607 at September 30, 2014 and 14,383,418 at December 31, 2013	195	195

Edgar Filing: PIPER JAFFRAY COMPANIES - Form 10-Q

Additional paid-in capital	737,449	740,321
Retained earnings	214,522	163,893
Less common stock held in treasury, at cost: 4,414,764 shares at September 30, 2014 and 5,153,709 shares at December 31, 2013	(148,286 )	(170,629 )
Accumulated other comprehensive income	753	896
Total common shareholders' equity	804,633	734,676
Noncontrolling interests	140,715	147,396
Total shareholders' equity	945,348	882,072
Total liabilities and shareholders' equity	\$2,600,540	\$2,318,157
See Notes to the Consolidated Financial Statements		

3

---

Table of ContentsPiper Jaffray Companies  
Consolidated Statements of Operations  
(Unaudited)

(Amounts in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Revenues:				
Investment banking	\$94,911	\$62,848	\$287,198	\$156,924
Institutional brokerage	35,923	35,318	114,485	100,076
Asset management	21,595	18,701	64,820	55,584
Interest	10,828	12,360	36,935	35,469
Investment income	2,690	5,279	12,379	8,285
Total revenues	165,947	134,506	515,817	356,338
Interest expense	6,521	6,192	18,227	18,719
Net revenues	159,426	128,314	497,590	337,619
Non-interest expenses:				
Compensation and benefits	97,180	79,426	300,745	210,531
Occupancy and equipment	8,312	6,509	22,151	18,869
Communications	5,661	5,778	17,048	16,040
Floor brokerage and clearance	1,905	2,109	5,527	6,506
Marketing and business development	6,827	5,447	19,787	16,384
Outside services	9,155	8,082	27,837	23,745
Restructuring and integration costs	—	3,823	—	3,823
Intangible asset amortization expense	2,318	2,899	6,954	6,221
Other operating expenses	2,376	2,181	8,719	1,939
Total non-interest expenses	133,734	116,254	408,768	304,058
Income from continuing operations before income tax expense	25,692	12,060	88,822	33,561
Income tax expense	8,596	2,886	28,472	10,130
Income from continuing operations	17,096	9,174	60,350	23,431
Discontinued operations:				
Loss from discontinued operations, net of tax	—	(1,529)	) —	(3,921)
Net income	17,096	7,645	60,350	19,510
Net income applicable to noncontrolling interests	2,428	2,323	9,721	1,554

Edgar Filing: PIPER JAFFRAY COMPANIES - Form 10-Q

Net income applicable to Piper Jaffray Companies	\$ 14,668	\$ 5,322	\$ 50,629	\$ 17,956
Net income applicable to Piper Jaffray Companies' common shareholders	\$ 13,552	\$ 4,826	\$ 46,386	\$ 16,163

Continued on next page

4

---

Table of Contents

Piper Jaffray Companies

Consolidated Statements of Operations – Continued

(Unaudited)

(Amounts in thousands, except per share data)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Amounts applicable to Piper Jaffray Companies				
Net income from continuing operations	\$14,668	\$6,851	\$50,629	\$21,877
Net loss from discontinued operations	—	(1,529	) —	(3,921 )
Net income applicable to Piper Jaffray Companies	\$14,668	\$5,322	\$50,629	\$17,956
Earnings/(loss) per basic common share				
Income from continuing operations	\$0.90	\$0.42	\$3.12	\$1.29
Loss from discontinued operations	—	(0.09	) —	(0.23 )
Earnings per basic common share	\$0.90	\$0.33	\$3.12	\$1.06
Earnings/(loss) per diluted common share				
Income from continuing operations	\$0.90	\$0.42	\$3.11	\$1.29
Loss from discontinued operations	—	(0.09	) —	(0.23 )
Earnings per basic common share	\$0.90	\$0.33	\$3.11	\$1.06
Weighted average number of common shares outstanding				
Basic	15,066	14,621	14,880	15,271
Diluted	15,129	14,626	14,934	15,284
See Notes to the Consolidated Financial Statements				

Table of Contents

Piper Jaffray Companies

Consolidated Statements of Comprehensive Income

(Unaudited)

(Amounts in thousands)	Three Months Ended September 30,		Nine Months Ended September 30,		
	2014	2013	2014	2013	
Net income	\$17,096	\$7,645	\$60,350	\$19,510	
Other comprehensive income/(loss), net of tax:					
Adjustment to unrecognized pension cost	—	(38	) —	(38	)
Foreign currency translation adjustment	(399	) 175	(143	) 54	
Total other comprehensive income/(loss), net of tax	(399	) 137	(143	) 16	
Comprehensive income	16,697	7,782	60,207	19,526	
Comprehensive income applicable to noncontrolling interests	2,428	2,323	9,721	1,554	
Comprehensive income applicable to Piper Jaffray Companies	\$14,269	\$5,459	\$50,486	\$17,972	
See Notes to the Consolidated Financial Statements					

Table of ContentsPiper Jaffray Companies  
Consolidated Statements of Cash Flows  
(Unaudited)

(Dollars in thousands)	Nine Months Ended	
	September 30, 2014	2013
Operating Activities:		
Net income	\$60,350	\$19,510
Adjustments to reconcile net income to net cash provided by/(used in) operating activities:		
Depreciation and amortization of fixed assets	3,992	4,300
Deferred income taxes	(2,487)	) 5,933
Loss on sale of FAMCO	—	1,876
Share-based and deferred compensation	21,067	11,012
Amortization of intangible assets	6,954	6,221
Amortization of forgivable loans	3,961	4,827
Decrease/(increase) in operating assets:		
Cash and cash equivalents segregated for regulatory purposes	4,983	5,999
Receivables:		
Customers	(14,036)	) (17,580)
Brokers, dealers and clearing organizations	(164,077)	) (94,186)
Securities purchased under agreements to resell	(95,805)	) (81,990)
Net financial instruments and other inventory positions owned	136,592	(163,710)
Investments	(13,124)	) (19,375)
Other assets	3,298	2,945
Increase/(decrease) in operating liabilities:		
Payables:		
Customers	2,835	(1,229)
Brokers, dealers and clearing organizations	56,622	65,071
Accrued compensation	25,741	(26,425)
Other liabilities and accrued expenses	(4,559)	) (23,566)
Decrease in assets held for sale	—	605
Decrease in liabilities held for sale	—	(465)
Net cash provided by/(used in) operating activities	32,307	(300,227)
Investing Activities:		
Business acquisitions, net of cash acquired	—	(24,726)
Sale of FAMCO	—	250
Purchases of fixed assets, net	(5,270)	) (3,257)
Net cash used in investing activities	(5,270)	) (27,733)

Continued on next page

Table of Contents

Piper Jaffray Companies

Consolidated Statements of Cash Flows – Continued

(Unaudited)

(Dollars in thousands)	Nine Months Ended	
	September 30, 2014	2013
Financing Activities:		
Increase/(decrease) in short-term financing	\$(175,916	) \$186,275
Issuance of variable rate senior notes	50,000	—
Repayment of variable rate senior notes	(50,000	) —
Increase in securities sold under agreements to repurchase	62,576	28,914
Increase/(decrease) in noncontrolling interests	(16,402	) 91,192
Repurchase of common stock	(10,563	) (69,947
Excess tax benefit from share-based compensation	1,006	39
Proceeds from stock option exercises	3,644	—
Net cash provided by/(used in) financing activities	(135,655	) 236,473
Currency adjustment:		
Effect of exchange rate changes on cash	(118	) 77
Net decrease in cash and cash equivalents	(108,736	) (91,410
Cash and cash equivalents at beginning of period	123,683	105,371
Cash and cash equivalents at end of period	\$14,947	\$13,961
Supplemental disclosure of cash flow information –		
Cash paid during the period for:		
Interest	\$17,116	\$17,938
Income taxes	\$45,284	\$2,870
Non-cash financing activities –		
Issuance of common stock for retirement plan obligations:		
103,598 shares and 96,049 shares for the nine months ended September 30, 2014 and 2013, respectively	\$4,156	\$3,939
Issuance of restricted common stock for annual equity award:		
402,074 shares and 431,582 shares for the nine months ended September 30, 2014 and 2013, respectively	\$16,131	\$17,699

See Notes to the Consolidated Financial Statements

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

Index		
Note 1	<u>Organization and Basis of Presentation</u>	<u>10</u>
Note 2	<u>Summary of Significant Accounting Policies</u>	<u>11</u>
Note 3	<u>Recent Accounting Pronouncements</u>	<u>11</u>
Note 4	<u>Acquisitions</u>	<u>12</u>
Note 5	<u>Discontinued Operations</u>	<u>13</u>
Note 6	<u>Financial Instruments and Other Inventory Positions Owned and Financial Instruments and Other Inventory Positions Sold, but Not Yet Purchased</u>	<u>14</u>
Note 7	<u>Fair Value of Financial Instruments</u>	<u>16</u>
Note 8	<u>Variable Interest Entities</u>	<u>25</u>
Note 9	<u>Receivables from and Payables to Brokers, Dealers and Clearing Organizations</u>	<u>26</u>
Note 10	<u>Collateralized Securities Transactions</u>	<u>26</u>
Note 11	<u>Investments</u>	<u>28</u>
Note 12	<u>Other Assets</u>	<u>28</u>
Note 13	<u>Goodwill and Intangible Assets</u>	<u>29</u>
Note 14	<u>Short-Term Financing</u>	<u>30</u>
Note 15	<u>Variable Rate Senior Notes</u>	<u>30</u>
Note 16	<u>Contingencies and Commitments</u>	<u>31</u>
Note 17	<u>Restructuring</u>	<u>32</u>
Note 18	<u>Shareholders' Equity</u>	<u>32</u>
Note 19	<u>Noncontrolling Interests</u>	<u>33</u>
Note 20	<u>Compensation Plans</u>	<u>34</u>
Note 21	<u>Earnings Per Share</u>	<u>38</u>
Note 22	<u>Segment Reporting</u>	<u>39</u>
Note 23	<u>Net Capital Requirements and Other Regulatory Matters</u>	<u>41</u>
Note 24	<u>Income Taxes</u>	<u>41</u>

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

Note 1 Organization and Basis of Presentation

Organization

Piper Jaffray Companies is the parent company of Piper Jaffray & Co. ("Piper Jaffray"), a securities broker dealer and investment banking firm; Piper Jaffray Ltd., a firm providing securities brokerage and mergers and acquisitions services in Europe headquartered in London, England; Advisory Research, Inc. ("ARI"), which provides asset management services to separately managed accounts, closed-end and open-end funds and partnerships; Piper Jaffray Investment Group Inc., which consists of entities providing alternative asset management services; Piper Jaffray Financial Products Inc., Piper Jaffray Financial Products II Inc. and Piper Jaffray Financial Products III Inc., entities that facilitate derivative transactions; and other immaterial subsidiaries. Piper Jaffray Companies and its subsidiaries (collectively, the "Company") operate in two reporting segments: Capital Markets and Asset Management. A summary of the activities of each of the Company's business segments is as follows:

Capital Markets

The Capital Markets segment provides institutional sales, trading and research services and investment banking services. Institutional sales, trading and research services focus on the trading of equity and fixed income products with institutions, government and non-profit entities. Revenues are generated through commissions and sales credits earned on equity and fixed income institutional sales activities, net interest revenues on trading securities held in inventory, and profits and losses from trading these securities. Investment banking services include management of and participation in underwritings, merger and acquisition services and public finance activities. Revenues are generated through the receipt of advisory and financing fees. Also, the Company generates revenue through strategic trading and investing activities, which focus on proprietary investments in a variety of securities, including municipal bonds, mortgage-backed securities, and equity securities, and merchant banking activities involving equity or debt investments in late stage private companies. As certain of these efforts have matured and an investment process has been developed, the Company has created alternative asset management funds in merchant banking and municipal securities in order to invest firm capital as well as to seek capital from outside investors. The Company receives management and performance fees for managing these funds.

As discussed in Note 5, the Company discontinued its Hong Kong capital markets business in 2012.

Asset Management

The Asset Management segment provides traditional asset management services with product offerings in equity securities and master limited partnerships to institutions and individuals. Revenues are generated in the form of management and performance fees. Revenues are also generated through investments in the partnerships and funds that the Company manages.

As discussed in Note 5, Fiduciary Asset Management, LLC ("FAMCO") was sold in 2013.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") and include the accounts of Piper Jaffray Companies, its wholly owned subsidiaries, and all other entities in which the Company has a controlling financial interest. Noncontrolling interests

represent equity interests in consolidated entities that are not attributable, either directly or indirectly, to Piper Jaffray Companies. Noncontrolling interests include the minority equity holders' proportionate share of the equity in a municipal bond fund, merchant banking fund and private equity investment vehicles. All material intercompany balances have been eliminated.

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates and assumptions are based on the best information available, actual results could differ from those estimates.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

Reclassifications

In 2013, the Company reclassified interest revenue and expense associated with its derivative contracts to investment banking or institutional brokerage revenues within the consolidated statements of operations to more accurately reflect the nature and intent of the derivative instrument. The Company reclassified \$3.9 million and \$8.5 million of interest revenue and \$4.3 million and \$9.8 million of interest expense for the three and nine months ended September 30, 2013, respectively. This change had no effect on net revenues, net income, shareholders' equity or cash flows for the periods presented.

Note 2 Summary of Significant Accounting Policies

Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for a full description of the Company's significant accounting policies.

Note 3 Recent Accounting Pronouncements

Adoption of New Accounting Standards

Investment Companies

In June 2013, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2013-08, "Financial Services - Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements," ("ASU 2013-08") amending FASB Accounting Standards Codification Topic 946, "Financial Services - Investment Companies" ("ASC 946"). The amended guidance changes the approach to the investment company assessment in ASC 946, clarifies the characteristics of an investment company and requires new disclosures for investment company financial statements. ASU 2013-08 was effective for the Company as of January 1, 2014. The adoption of ASU 2013-08 did not impact the Company's results of operations, financial position or disclosures.

Future Adoption of New Accounting Standards

Discontinued Operations

In April 2014, the FASB issued ASU No. 2014-08, "Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity," ("ASU 2014-08") amending FASB Accounting Standards Codification Topic 205-20, "Discontinued Operations" ("ASC 205-20"). The amended guidance changes the criteria for reporting discontinued operations and requires new disclosures. ASU 2014-08 is effective for annual and interim periods beginning on or after December 15, 2014, and will be applied prospectively.

Revenue Recognition

In May 2014, the FASB issued ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)," ("ASU 2014-09") which supersedes current revenue recognition guidance, including most industry-specific guidance. ASU 2014-09 requires a company to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods and

services. The guidance also requires additional disclosures regarding the nature, amount, timing and uncertainty of revenue that is recognized. ASU 2014-09 is effective for annual and interim periods beginning after December 15, 2016. Early adoption is not permitted. The Company is evaluating the impact of the new guidance on its consolidated financial statements.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

Repurchase Agreements

In June 2014, the FASB issued ASU No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures," ("ASU 2014-11") amending FASB Accounting Standards Codification Topic 860, "Transfers and Servicing." The amended guidance changes the accounting for repurchase-to-maturity transactions and repurchase financing arrangements. The guidance also requires new disclosures for certain transfers accounted for as sales and collateral supporting transactions that are accounted for as secured borrowings. ASU 2014-11 is effective for annual and interim periods beginning after December 15, 2014, except for the disclosures related to secured borrowings, which are effective for annual periods beginning after December 15, 2014, and for interim periods beginning after March 15, 2015. The adoption of ASU 2014-11 is not expected to have a material impact on the Company's results of operations or financial position, but may impact the Company's disclosures.

Going Concern

In August 2014, the FASB issued ASU No. 2014-15, "Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern" ("ASU 2014-15"). ASU 2014-15 provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related disclosures thereon. The guidance is effective for annual and interim periods ending after December 15, 2016, with early adoption permitted. The adoption of ASU 2014-15 is not expected to impact the Company's results of operations, financial position or disclosures.

Note 4 Acquisitions

On July 12, 2013, the Company completed the purchase of Seattle-Northwest Securities Corporation ("Seattle-Northwest"), a Seattle-based investment bank and broker dealer focused on public finance in the Northwest region of the U.S. The purchase was completed pursuant to the Agreement and Plan of Merger dated April 16, 2013. The acquisition of Seattle-Northwest supports the Company's strategy to grow its public finance business.

On July 16, 2013, the Company completed the purchase of Edgeview Partners, L.P. ("Edgeview"), a middle-market advisory firm specializing in mergers and acquisitions. The purchase was completed pursuant to the Unit Purchase Agreement dated June 17, 2013. The acquisition of Edgeview further strengthened the Company's mergers and acquisitions position in the middle market and added resources dedicated to the private equity community.

The Company paid \$32.7 million in cash for Seattle-Northwest and Edgeview, which represented the fair values as of the respective acquisition dates. The Company also entered into acquisition-related compensation arrangements of \$14.3 million which consisted of cash, restricted stock and restricted mutual fund shares ("MFRS Awards") of registered funds managed by the Company's asset management business. Compensation expense related to these arrangements will be amortized on a straight-line basis over the requisite service period of two to five years (a weighted average service period of 4.3 years).

These acquisitions were accounted for pursuant to FASB Accounting Standards Codification Topic 805, "Business Combinations." Accordingly, the purchase price of each acquisition was allocated to the acquired assets and liabilities assumed based on their estimated fair values as of the respective acquisition dates. The excess of the purchase price over the net assets acquired was allocated between goodwill and intangible assets within the Capital Markets segment.

The Company recorded \$15.0 million of goodwill on the consolidated statements of financial condition, of which \$9.1 million is expected to be deductible for income tax purposes. In management's opinion, the goodwill represents the reputation and expertise of Seattle-Northwest and Edgeview in their respective business lines.

Identifiable intangible assets purchased by the Company consisted of customer relationships and non-competition agreements with acquisition-date fair values estimated to be \$6.0 million and \$0.7 million, respectively. Transaction costs of \$0.9 million were incurred in the three and nine months ended September 30, 2013, respectively, and are included in restructuring and integration costs within continuing operations on the consolidated statements of operations.

Table of Contents

Piper Jaffray Companies  
Notes to the Consolidated Financial Statements  
(Unaudited)

The following table summarizes the estimated fair values of assets acquired and liabilities assumed at the respective dates of acquisition:

(Dollars in thousands)

Assets	
Cash and cash equivalents	\$8,014
Financial instruments and other inventory positions owned	24,074
Fixed assets	1,247
Goodwill	15,034
Intangible assets	6,665
Other assets	7,678
Total assets acquired	62,712
Liabilities	
Payables	1,126
Financial instruments and other inventory positions sold, but not yet purchased	22,588
Accrued compensation	1,469
Other liabilities and accrued expenses	4,789
Total liabilities assumed	29,972

Net assets acquired \$32,740

Seattle-Northwest and Edgeview results of operations have been included in the Company's consolidated financial statements prospectively from their respective dates of acquisition. These acquisitions have been fully integrated with the Company's existing operations. Accordingly, post-acquisition revenues and net income are not discernible. The following unaudited pro forma financial data assumes the acquisitions had occurred on January 1, 2012, the beginning of the prior annual period in which the acquisitions occurred. Pro forma results have been prepared by adjusting the Company's historical results from continuing operations to include Seattle-Northwest and Edgeview results of operations adjusted for the following changes: depreciation and amortization expenses were adjusted to account for acquisition-date fair value adjustments of fixed assets and intangible assets; compensation and benefits expenses were adjusted to reflect excess partner distributions as compensation expense; and the income tax effect of applying the Company's statutory tax rates to Seattle-Northwest and Edgeview results of operations. The consolidated Company's unaudited pro forma information presented does not necessarily reflect the results of operations that would have resulted had the acquisitions been completed at the beginning of the applicable period presented, does not contemplate anticipated operational efficiencies of the combined entities, nor does it indicate the results of operations in future periods.

(Dollars in thousands)	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2013
Net revenues	\$132,773	\$353,728
Net income from continuing operations applicable to Piper Jaffray Companies	\$6,921	\$20,276

#### Note 5 Discontinued Operations

The Company's Hong Kong capital markets business ceased operations in 2012. In the second quarter of 2013, the Company completed the sale of FAMCO, an asset management subsidiary, for consideration of \$4.0 million which consisted of \$0.3 million in cash and a \$3.7 million note receivable from the buyer. In accordance with the provisions of ASC 205-20, the results from these businesses have been classified as discontinued operations for all periods

presented. The Company recorded a \$1.5 million net loss and a \$3.9 million net loss from discontinued operations for the three and nine months ended September 30, 2013, respectively.

Table of Contents

Piper Jaffray Companies  
Notes to the Consolidated Financial Statements  
(Unaudited)

Note 6 Financial Instruments and Other Inventory Positions Owned and Financial Instruments and Other Inventory Positions Sold, but Not Yet Purchased

Financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased were as follows:

(Dollars in thousands)	September 30, 2014	December 31, 2013
Financial instruments and other inventory positions owned:		
Corporate securities:		
Equity securities	\$54,386	\$54,097
Convertible securities	164,580	80,784
Fixed income securities	41,482	10,102
Municipal securities:		
Taxable securities	306,534	232,379
Tax-exempt securities	365,563	460,865
Short-term securities	78,222	62,620
Asset-backed securities	99,294	119,811
U.S. government agency securities	322,284	304,737
Derivative contracts	51,249	38,633
Total financial instruments and other inventory positions owned	1,483,594	1,364,028
Less noncontrolling interests (1)	(234,876 )	(291,513 )
	\$1,248,718	\$1,072,515
Financial instruments and other inventory positions sold, but not yet purchased:		
Corporate securities:		
Equity securities	\$158,479	\$69,205
Fixed income securities	23,498	24,021
U.S. government agency securities	70,992	120,084
U.S. government securities	505,689	291,320
Derivative contracts	10,333	8,203
Total financial instruments and other inventory positions sold, but not yet purchased	768,991	512,833
Less noncontrolling interests (2)	(113,773 )	(68,356 )
	\$655,218	\$444,477

(1) Noncontrolling interests attributable to third party ownership in a consolidated municipal bond fund consist of \$127.4 million and \$101.8 million of taxable municipal securities, \$102.7 million and \$183.9 million of tax-exempt municipal securities, and \$4.8 million and \$5.8 million of derivative contracts as of September 30, 2014 and December 31, 2013, respectively.

(2) Noncontrolling interests attributable to third party ownership in a consolidated municipal bond fund consist of \$112.5 million and \$67.4 million of U.S. government securities, and \$1.3 million and \$1.0 million of derivative contracts as of September 30, 2014 and December 31, 2013, respectively.

At September 30, 2014 and December 31, 2013, financial instruments and other inventory positions owned in the amount of \$1.0 billion and \$957.5 million, respectively, had been pledged as collateral for short-term financings and

repurchase agreements.

Financial instruments and other inventory positions sold, but not yet purchased represent obligations of the Company to deliver the specified security at the contracted price, thereby creating a liability to purchase the security in the market at prevailing prices. The Company is obligated to acquire the securities sold short at prevailing market prices, which may exceed the amount reflected on the consolidated statements of financial condition. The Company economically hedges changes in the market value of its financial instruments and other inventory positions owned using inventory positions sold, but not yet purchased, interest rate derivatives, credit default swap index contracts, treasury futures and exchange traded options.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

## Derivative Contract Financial Instruments

The Company uses interest rate swaps, interest rate locks, credit default swap index contracts, treasury futures and option contracts to facilitate customer transactions and as a means to manage risk in certain inventory positions. The following describes the Company's derivatives by the type of transaction or security the instruments are economically hedging.

Customer matched-book derivatives: The Company enters into interest rate derivative contracts in a principal capacity as a dealer to satisfy the financial needs of its customers. The Company simultaneously enters into an interest rate derivative contract with a third party for the same notional amount to hedge the interest rate and credit risk of the initial client interest rate derivative contract. In certain limited instances, the Company has only hedged interest rate risk with a third party, and retains uncollateralized credit risk as described below. The instruments use interest rates based upon either the London Interbank Offer Rate ("LIBOR") index or the Securities Industry and Financial Markets Association ("SIFMA") index.

Trading securities derivatives: The Company enters into interest rate derivative contracts to hedge interest rate and market value risks associated with its fixed income securities. The instruments use interest rates based upon either the Municipal Market Data ("MMD") index, LIBOR or the SIFMA index. The Company also enters into credit default swap index contracts to hedge credit risk associated with its taxable fixed income securities and option contracts to hedge market value risk associated with its convertible securities and asset-backed securities.

The following table presents the total absolute notional contract amount associated with the Company's outstanding derivative instruments:

(Dollars in thousands)		September 30,	December 31,
Transaction Type or Hedged Security	Derivative Category	2014	2013
Customer matched-book	Interest rate derivative contract	\$4,917,596	\$5,310,929
Trading securities	Interest rate derivative contract	307,450	198,500
Trading securities	Credit default swap index contract	397,815	299,333
Trading securities	Equity option derivative contract	13,522	17,090
		\$5,636,383	\$5,825,852

The Company's derivative contracts do not qualify for hedge accounting, therefore, unrealized gains and losses are recorded on the consolidated statements of operations. The gains and losses on the related economically hedged inventory positions are not disclosed below as they are not in qualifying hedging relationships. The following table presents the Company's unrealized gains/(losses) on derivative instruments:

(Dollars in thousands)		Three Months Ended		Nine Months Ended	
Derivative Category		September 30,		September 30,	
	Operations Category	2014	2013	2014	2013
Interest rate derivative contract	Investment banking	\$(809)	\$(483)	\$(2,178)	\$(1,132)
	Institutional brokerage	1,368	(16,532)	(2,898)	4,930

Interest rate derivative contract					
Credit default swap index contract	Institutional brokerage	2,078	(1,918	) (845	) (650
Equity option derivative contract	Institutional brokerage	693	—	1,112	—
		\$3,330	\$(18,933	) \$(4,809	) \$3,148

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

The gross fair market value of all derivative instruments and their location on the Company's consolidated statements of financial condition prior to counterparty netting are shown below by asset or liability position:

(Dollars in thousands)		Asset Value at		Liability Value at	
		September 30,		September 30,	
Derivative Category	Financial Condition Location	2014	Financial Condition Location	2014	
Interest rate derivative contract	Financial instruments and other inventory positions owned	\$ 389,825	Financial instruments and other inventory positions sold, but not yet purchased		\$ 375,723
Credit default swap index contract	Financial instruments and other inventory positions owned	7,025	Financial instruments and other inventory positions sold, but not yet purchased		7,999
Equity option derivative contract	Financial instruments and other inventory positions owned	63	Financial instruments and other inventory positions sold, but not yet purchased		247
		\$ 396,913			\$ 383,969

Derivatives are reported on a net basis by counterparty (i.e., the net payable or receivable for derivative assets and liabilities for a given counterparty) when a legal right of offset exists and on a net basis by cross product when applicable provisions are stated in master netting agreements. Cash collateral received or paid is netted on a counterparty basis, provided a legal right of offset exists.

Credit risk associated with the Company's derivatives is the risk that a derivative counterparty will not perform in accordance with the terms of the applicable derivative contract. Credit exposure associated with the Company's derivatives is driven by uncollateralized market movements in the fair value of the contracts with counterparties and is monitored regularly by the Company's financial risk committee. The Company considers counterparty credit risk in determining derivative contract fair value. The majority of the Company's derivative contracts are substantially collateralized by its counterparties, who are major financial institutions. The Company has a limited number of counterparties who are not required to post collateral. Based on market movements, the uncollateralized amounts representing the fair value of the derivative contract can become material, exposing the Company to the credit risk of these counterparties. As of September 30, 2014, the Company had \$25.2 million of uncollateralized credit exposure with these counterparties (notional contract amount of \$199.2 million), including \$13.3 million of uncollateralized credit exposure with one counterparty.

## Note 7 Fair Value of Financial Instruments

Based on the nature of the Company's business and its role as a "dealer" in the securities industry or as a manager of alternative asset management funds, the fair values of its financial instruments are determined internally. The Company's processes are designed to ensure that the fair values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, unobservable inputs are developed based on an evaluation of all relevant empirical market data, including prices evidenced by market transactions, interest rates, credit spreads, volatilities and correlations and other security-specific information. Valuation

adjustments related to illiquidity or counterparty credit risk are also considered. In estimating fair value, the Company may utilize information provided by third-party pricing vendors to corroborate internally-developed fair value estimates.

The Company employs specific control processes to determine the reasonableness of the fair value of its financial instruments. The Company's processes are designed to ensure that the internally estimated fair values are accurately recorded and that the data inputs and the valuation techniques used are appropriate, consistently applied, and that the assumptions are reasonable and consistent with the objective of determining fair value. Individuals outside of the trading departments perform independent pricing verification reviews as of each reporting date. The Company has established parameters which set forth when the fair value of securities are independently verified. The selection parameters are generally based upon the type of security, the level of estimation risk of a security, the materiality of the security to the Company's financial statements, changes in fair value from period to period, and other specific facts and circumstances of the Company's securities portfolio. In evaluating the initial internally-estimated fair values made by the Company's traders, the nature and complexity of securities involved (e.g., term, coupon, collateral, and other key drivers of value), level of market activity for securities, and availability of market data are considered. The independent price verification procedures include, but are not limited to, analysis of trade data (both internal and external where available), corroboration to the valuation of positions with similar characteristics, risks and components, or comparison to an alternative pricing source, such as a discounted cash flow model. The Company's valuation committee, comprised of members of senior

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

management and risk management, provides oversight and overall responsibility for the internal control processes and procedures related to fair value measurements.

The following is a description of the valuation techniques used to measure fair value.

Cash Equivalents

Cash equivalents include highly liquid investments with original maturities of 90 days or less. Actively traded money market funds are measured at their net asset value and classified as Level I.

Financial Instruments and Other Inventory Positions Owned

The Company records financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased at fair value on the consolidated statements of financial condition with unrealized gains and losses reflected on the consolidated statements of operations.

Equity securities – Exchange traded equity securities are valued based on quoted prices from the exchange for identical assets or liabilities as of the period-end date. To the extent these securities are actively traded and valuation adjustments are not applied, they are categorized as Level I. Non-exchange traded equity securities (principally hybrid preferred securities) are measured primarily using broker quotations, prices observed for recently executed market transactions and internally-developed fair value estimates based on observable inputs and are categorized within Level II of the fair value hierarchy.

Convertible securities – Convertible securities are valued based on observable trades, when available. Accordingly, these convertible securities are categorized as Level II. When observable price quotations are not available, fair value is determined using model-based valuation techniques with observable market inputs, such as specific company stock price and volatility, and unobservable inputs such as option adjusted spreads over the U.S. treasury securities curve. These instruments are categorized as Level III.

Corporate fixed income securities – Fixed income securities include corporate bonds which are valued based on recently executed market transactions of comparable size, internally-developed fair value estimates based on observable inputs, or broker quotations. Accordingly, these corporate bonds are categorized as Level II. When observable price quotations or certain observable inputs are not available, fair value is determined using model-based valuation techniques with observable inputs such as specific security contractual terms and yield curves, and unobservable inputs such as credit spreads over U.S. treasury securities. Corporate bonds measured using model-based valuation techniques are categorized as Level III.

Taxable municipal securities – Taxable municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II.

Tax-exempt municipal securities – Tax-exempt municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II. Certain illiquid tax-exempt municipal securities are valued using market data for comparable securities (maturity and sector) and management judgment to infer an appropriate current yield or other model-based valuation techniques deemed appropriate by management based on the specific nature of the individual security and are therefore categorized as Level III.

Short-term municipal securities – Short-term municipal securities include auction rate securities, variable rate demand notes, and other short-term municipal securities. Variable rate demand notes and other short-term municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II. Auction rate securities with limited liquidity are categorized as Level III and are valued using discounted cash flow models with unobservable inputs such as the Company’s expected recovery rate on the securities.

Asset-backed securities – Asset-backed securities are valued using observable trades, when available. Certain asset-backed securities are valued using models where inputs to the model are directly observable in the market, or can be derived principally from or corroborated by observable market data. These asset-backed securities are categorized as Level II. Other asset-backed securities, which are principally collateralized by residential mortgages, have experienced low volumes of executed transactions resulting in less observable transaction data. Certain asset-backed securities collateralized by residential mortgages are valued using cash flow models that utilize unobservable inputs including credit default rates, prepayment rates, loss severity and valuation yields. As judgment is used to determine the range of these inputs, these asset-backed securities are categorized as Level III.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

U.S. government agency securities – U.S. government agency securities include agency debt bonds and mortgage bonds. Agency debt bonds are valued by using either direct price quotes or price quotes for comparable bond securities and are categorized as Level II. Mortgage bonds include bonds secured by mortgages, mortgage pass-through securities, agency collateralized mortgage-obligation (“CMO”) securities and agency interest-only securities. Mortgage pass-through securities, CMO securities and interest-only securities are valued using recently executed observable trades or other observable inputs, such as prepayment speeds and therefore are generally categorized as Level II. Mortgage bonds are valued using observable market inputs, such as market yields ranging from 11-598 basis points (“bps”) on spreads over U.S. treasury securities, or models based upon prepayment expectations ranging from 102-324 Public Securities Association (“PSA”) prepayment levels. These securities are categorized as Level II.

U.S. government securities – U.S. government securities include highly liquid U.S. treasury securities which are generally valued using quoted market prices and therefore categorized as Level I. The Company does not transact in securities of countries other than the U.S. government.

Derivatives – Derivative contracts include interest rate and basis swaps, forward purchase agreements, interest rate locks, treasury futures, options and credit default swap index contracts. These instruments derive their value from underlying assets, reference rates, indices or a combination of these factors. The Company's equity option derivative contracts are valued based on quoted prices from the exchange for identical assets or liabilities as of the period-end date. To the extent these contracts are actively traded and valuation adjustments are not applied, they are categorized as Level I. The Company's credit default swap index contracts are valued using market price quotations and are classified as Level II. The majority of the Company's interest rate derivative contracts, including both interest rate swaps and interest rate locks, are valued using market standard pricing models based on the net present value of estimated future cash flows. The valuation models used do not involve material subjectivity as the methodologies do not entail significant judgment and the pricing inputs are market observable, including contractual terms, yield curves and measures of volatility. These instruments are classified as Level II within the fair value hierarchy. Certain interest rate locks transact in less active markets and were valued using valuation models that included the previously mentioned observable inputs and certain unobservable inputs that required significant judgment, such as the premium over the MMD curve. These instruments are classified as Level III.

Investments

The Company's investments valued at fair value include equity investments in private companies, investments in public companies, investments in registered mutual funds, and warrants of public or private companies. Exchange traded direct equity investments in public companies and registered mutual funds are valued based on quoted prices on active markets and classified as Level I. Company-owned warrants, which have a cashless exercise option, are valued based upon the Black-Scholes option-pricing model and certain unobservable inputs. The Company applies a liquidity discount to the value of its warrants in public and private companies. For warrants in private companies, valuation adjustments, based upon management's judgment, are made to account for differences between the measured security and the stock volatility factors of comparable companies. Company-owned warrants are reported as Level III assets. Equity securities in private companies are valued based on an assessment of each underlying security, considering rounds of financing, third-party transactions and market-based information, including comparable company transactions, trading multiples (e.g., multiples of revenue and earnings before interest, taxes, depreciation and amortization (“EBITDA”)) and changes in market outlook, among other factors. These securities are generally categorized as Level III.

Fair Value Option – The fair value option permits the irrevocable fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The fair value option was elected for certain merchant banking and other investments at inception to reflect economic events in earnings on a timely basis. Merchant banking and other equity investments of \$17.9 million and \$16.1 million, included within investments on the consolidated statements of financial condition, are accounted for at fair value and are classified as Level III assets at September 30, 2014 and December 31, 2013, respectively. The realized and unrealized gains from fair value changes included in earnings as a result of electing to apply the fair value option to certain financial assets were \$2.1 million and \$9.5 million for the nine months ended September 30, 2014 and 2013, respectively.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

The following table summarizes quantitative information about the significant unobservable inputs used in the fair value measurement of the Company's Level III financial instruments as of September 30, 2014:

	Valuation Technique	Unobservable Input	Range	Weighted Average
Assets:				
Financial instruments and other inventory positions owned:				
Municipal securities:				
Tax-exempt securities	Discounted cash flow	Debt service coverage ratio (2)	5 - 69%	22.2%
Short-term securities	Discounted cash flow	Expected recovery rate (% of par) (2)	77 - 80%	79.6%
Asset-backed securities:				
Collateralized by residential mortgages				
	Discounted cash flow	Credit default rates (3)	1 - 6%	3.4%
		Prepayment rates (4)	2 - 22%	4.3%
		Loss severity (3)	25 - 85%	66.0%
		Valuation yields (3)	5 - 10%	5.1%
Derivative contracts:				
Interest rate locks	Discounted cash flow	Premium over the MMD curve (1)	3 - 15 bps	11.4 bps
Investments at fair value:				
Warrants in public and private companies	Black-Scholes option pricing model	Liquidity discount rates (1)	30 - 40%	35.5%
Warrants in private companies	Black-Scholes option pricing model	Stock volatility factors of comparable companies (2)	23 - 94%	47.9%
Equity securities in private companies	Market approach	Revenue multiple (2)	2 - 6 times	3.6 times
		EBITDA multiple (2)	9 - 12 times	9.4 times

## Liabilities:

Financial instruments and other inventory positions

sold, but not yet purchased:

Derivative contracts:

Interest rate locks	Discounted cash flow	Premium over the MMD curve (1)	4 - 40 bps	15.9 bps
---------------------	----------------------	--------------------------------	------------	----------

Sensitivity of the fair value to changes in unobservable inputs:

(1) Significant increase/(decrease) in the unobservable input in isolation would result in a significantly lower/(higher) fair value measurement.

(2) Significant increase/(decrease) in the unobservable input in isolation would result in a significantly higher/(lower) fair value measurement.

Significant changes in any of these inputs in isolation could result in a significantly different fair value. Generally, (3) a change in the assumption used for credit default rates is accompanied by a directionally similar change in the assumption used for the loss severity and a directionally inverse change in the assumption for valuation yields.

(4)

The potential impact of changes in prepayment rates on fair value is dependent on other security-specific factors, such as the par value and structure. Changes in the prepayment rates may result in directionally similar or directionally inverse changes in fair value depending on whether the security trades at a premium or discount to the par value.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

The following table summarizes the valuation of the Company's financial instruments by pricing observability levels defined in FASB Accounting Standards Codification Topic 820, "Fair Value Measurement" ("ASC 820") as of September 30, 2014:

(Dollars in thousands)	Level I	Level II	Level III	Counterparty and Cash Collateral Netting (1)	Total
Assets:					
Financial instruments and other inventory positions owned:					
Corporate securities:					
Equity securities	\$46,087	\$8,299	\$—	\$—	\$54,386
Convertible securities	—	164,580	—	—	164,580
Fixed income securities	—	41,482	—	—	41,482
Municipal securities:					
Taxable securities	—	306,534	—	—	306,534
Tax-exempt securities	—	364,257	1,306	—	365,563
Short-term securities	—	77,491	731	—	78,222
Asset-backed securities	—	4,020	95,274	—	99,294
U.S. government agency securities	—	322,284	—	—	322,284
Derivative contracts	63	395,533	1,317	(345,664 )	51,249
Total financial instruments and other inventory positions owned:	46,150	1,684,480	98,628	(345,664 )	1,483,594
Cash equivalents	903	—	—	—	903
Investments at fair value	22,175	—	69,998	—	92,173
Total assets	\$69,228	\$1,684,480	\$168,626	\$(345,664 )	\$1,576,670
Liabilities:					
Financial instruments and other inventory positions sold, but not yet purchased:					
Corporate securities:					
Equity securities	\$157,598	\$881	\$—	\$—	\$158,479
Fixed income securities	—	23,498	—	—	23,498
U.S. government agency securities	—	70,992	—	—	70,992
U.S. government securities	505,689	—	—	—	505,689
Derivative contracts	247	373,555	10,167	(373,636 )	10,333
Total financial instruments and other inventory positions sold, but not yet purchased:	\$663,534	\$468,926	\$10,167	\$(373,636 )	\$768,991

(1) Represents cash collateral and the impact of netting on a counterparty basis. The Company had no securities posted as collateral to its counterparties.

20

---

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

The following table summarizes the valuation of the Company's financial instruments by pricing observability levels defined in ASC 820 as of December 31, 2013:

(Dollars in thousands)	Level I	Level II	Level III	Counterparty and Cash Collateral Netting (1)	Total
<b>Assets:</b>					
<b>Financial instruments and other inventory positions owned:</b>					
<b>Corporate securities:</b>					
Equity securities	\$39,711	\$14,386	\$—	\$—	\$54,097
Convertible securities	—	80,784	—	—	80,784
Fixed income securities	—	10,002	100	—	10,102
<b>Municipal securities:</b>					
Taxable securities	—	232,379	—	—	232,379
Tax-exempt securities	—	459,432	1,433	—	460,865
Short-term securities	—	61,964	656	—	62,620
Asset-backed securities	—	12	119,799	—	119,811
U.S. government agency securities	—	304,737	—	—	304,737
Derivative contracts	19	351,589	691	(313,666 )	38,633
<b>Total financial instruments and other inventory positions owned:</b>	<b>39,730</b>	<b>1,515,285</b>	<b>122,679</b>	<b>(313,666 )</b>	<b>1,364,028</b>
Cash equivalents	101,629	—	—	—	101,629
Investments at fair value	20,690	—	49,240	—	69,930
<b>Total assets</b>	<b>\$162,049</b>	<b>\$1,515,285</b>	<b>\$171,919</b>	<b>\$(313,666 )</b>	<b>\$1,535,587</b>
<b>Liabilities:</b>					
<b>Financial instruments and other inventory positions sold, but not yet purchased:</b>					
<b>Corporate securities:</b>					
Equity securities	\$69,205	\$—	\$—	\$—	\$69,205
Fixed income securities	—	24,021	—	—	24,021
U.S. government agency securities	—	120,084	—	—	120,084
U.S. government securities	291,320	—	—	—	291,320
Derivative contracts	1,889	324,065	6,643	(324,394 )	8,203
<b>Total financial instruments and other inventory positions sold, but not yet purchased:</b>	<b>\$362,414</b>	<b>\$468,170</b>	<b>\$6,643</b>	<b>\$(324,394 )</b>	<b>\$512,833</b>
(1)					

Represents cash collateral and the impact of netting on a counterparty basis. The Company had no securities posted as collateral to its counterparties.

The Company's Level III assets were \$168.6 million and \$171.9 million, or 10.7 percent and 11.2 percent of financial instruments measured at fair value at September 30, 2014 and December 31, 2013, respectively. The value of transfers between levels are recognized at the beginning of the reporting period. There were no significant transfers between Level I, Level II or Level III for the nine months ended September 30, 2014.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

The following tables summarize the changes in fair value associated with Level III financial instruments held at the beginning or end of the periods presented:

(Dollars in thousands)	Balance at June 30, 2014	Purchases	Sales	Transfers in	Transfers out	Realized gains/ (losses) (1)	Unrealized gains/ (losses) (1)	Balance at September 30, 2014
<b>Assets:</b>								
<b>Financial instruments and other inventory positions owned:</b>								
<b>Municipal securities:</b>								
Tax-exempt securities	\$ 1,306	\$—	\$—	\$—	\$—	\$—	\$—	\$ 1,306
Short-term securities	732	—	—	—	—	—	(1 )	731
Asset-backed securities	129,126	58,028	(93,801 )	515	—	1,377	29	95,274
Derivative contracts	627	—	—	—	—	—	690	1,317
<b>Total financial instruments and other inventory positions owned:</b>	<b>131,791</b>	<b>58,028</b>	<b>(93,801 )</b>	<b>515</b>	<b>—</b>	<b>1,377</b>	<b>718</b>	<b>98,628</b>
Investments at fair value	58,567	10,500	(9 )	—	—	9	931	69,998
<b>Total assets</b>	<b>\$ 190,358</b>	<b>\$ 68,528</b>	<b>\$(93,810 )</b>	<b>\$ 515</b>	<b>\$—</b>	<b>\$ 1,386</b>	<b>\$ 1,649</b>	<b>\$ 168,626</b>
<b>Liabilities:</b>								
<b>Financial instruments and other inventory positions sold, but not yet purchased:</b>								
Derivative contracts	\$ 10,846	\$(8,439 )	\$—	\$—	\$—	\$ 8,439	\$( 679 )	\$ 10,167
<b>Total financial instruments and other inventory positions sold, but not yet purchased:</b>	<b>\$ 10,846</b>	<b>\$(8,439 )</b>	<b>\$—</b>	<b>\$—</b>	<b>\$—</b>	<b>\$ 8,439</b>	<b>\$( 679 )</b>	<b>\$ 10,167</b>

Realized and unrealized gains/(losses) related to financial instruments, with the exception of customer matched-book derivatives, are reported in institutional brokerage on the consolidated statements of operations.

(1) Realized and unrealized gains/(losses) related to customer matched-book derivatives are reported in investment banking. Realized and unrealized gains/(losses) related to investments are reported in investment banking revenues or investment income/(loss) on the consolidated statements of operations.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

	Balance at June 30, 2013	Purchases	Sales	Transfers in	Transfers out	Realized gains/ (losses) (1)	Unrealized gains/ (losses) (1)	Balance at September 30, 2013
<b>Assets:</b>								
Financial instruments and other inventory positions owned:								
Corporate securities:								
Convertible securities	\$1,308	\$—	\$(1,615)	\$—	\$(251)	\$ 839	\$(281)	\$—
Fixed income securities	100	—	—	—	—	—	—	100
Municipal securities:								
Tax-exempt securities	1,433	—	—	—	—	—	—	1,433
Short-term securities	656	—	—	—	—	—	—	656
Asset-backed securities	151,396	99,763	(97,246)	—	—	(276)	3,405	157,042
Derivative contracts	17,879	—	(12,337)	—	—	12,337	(9,808)	8,071
Total financial instruments and other inventory positions owned:	172,772	99,763	(111,198)	—	(251)	12,900	(6,684)	167,302
Investments at fair value	53,567	—	(10,356)	—	(619)	5,942	(2,955)	45,579
Total assets	\$226,339	\$99,763	\$(121,554)	\$—	\$(870)	\$ 18,842	\$(9,639)	\$ 212,881
<b>Liabilities:</b>								
Financial instruments and other inventory positions sold, but not yet purchased:								
Derivative contracts	\$254	\$(223)	\$—	\$—	\$—	\$ 223	\$ 6,327	\$ 6,581
Total financial instruments and other inventory positions sold, but not yet purchased:	\$254	\$(223)	\$—	\$—	\$—	\$ 223	\$ 6,327	\$ 6,581

Realized and unrealized gains/(losses) related to financial instruments, with the exception of customer matched-book derivatives, are reported in institutional brokerage on the consolidated statements of operations.

(1) Realized and unrealized gains/(losses) related to customer matched-book derivatives are reported in investment banking. Realized and unrealized gains/(losses) related to investments are reported in investment banking revenues or investment income/(loss) on the consolidated statements of operations.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

	Balance at December 31, 2013	Purchases	Sales	Transfers in	Transfers out	Realized gains/ (losses) (1)	Unrealized gains/ (losses) (1)	Balance at September 30, 2014
(Dollars in thousands)								
Assets:								
Financial instruments and other inventory positions owned:								
Corporate securities:								
Fixed income securities	\$ 100	\$—	\$(100 )	\$—	\$—	\$—	\$—	\$—
Municipal securities:								
Tax-exempt securities	1,433	—	—	—	—	—	(127 )	1,306
Short-term securities	656	—	(25 )	—	—	6	94	731
Asset-backed securities	119,799	129,764	(163,047 )	—	—	9,748	(990 )	95,274
Derivative contracts	691	2,614	—	—	—	(2,614 )	626	1,317
Total financial instruments and other inventory positions owned:	122,679	132,378	(163,172 )	—	—	7,140	(397 )	98,628
Investments at fair value	49,240	20,500	(2,368 )	—	—	2,368	258	69,998
Total assets	\$ 171,919	\$ 152,878	\$(165,540)	\$—	\$—	\$ 9,508	\$ (139 )	\$ 168,626
Liabilities:								
Financial instruments and other inventory positions sold, but not yet purchased:								
Derivative contracts	\$ 6,643	\$(16,751 )	\$—	\$—	\$—	\$ 16,751	\$ 3,524	\$ 10,167
Total financial instruments and other inventory positions sold, but not yet purchased:	\$ 6,643	\$(16,751 )	\$—	\$—	\$—	\$ 16,751	\$ 3,524	\$ 10,167

Realized and unrealized gains/(losses) related to financial instruments, with the exception of customer matched-book derivatives, are reported in institutional brokerage on the consolidated statements of operations.

(1) Realized and unrealized gains/(losses) related to customer matched-book derivatives are reported in investment banking. Realized and unrealized gains/(losses) related to investments are reported in investment banking revenues or investment income/(loss) on the consolidated statements of operations.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

(Dollars in thousands)	Balance at December 31, 2012	Purchases	Sales	Transfers in	Transfers out	Realized gains/ (losses) (1)	Unrealized gains/ (losses) (1)	Balance at September 30, 2013
<b>Assets:</b>								
Financial instruments and other inventory positions owned:								
Corporate securities:								
Fixed income securities	\$ —	\$ 100	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 100
Municipal securities:								
Tax-exempt securities	1,429	1	—	—	—	(266 )	269	1,433
Short-term securities	656	—	—	—	—	—	—	656
Asset-backed securities	116,171	448,175	(424,274 )	—	—	20,562	(3,592 )	157,042
Derivative contracts	827	710	(13,318 )	—	—	12,523	7,329	8,071
Total financial instruments and other inventory positions owned:	119,083	448,986	(437,592 )	—	—	32,819	4,006	167,302
Investments at fair value	33,245	15,363	(10,356 )	—	(619 )	5,946	2,000	45,579
Total assets	\$ 152,328	\$ 464,349	\$ (447,948)	\$ —	\$ (619 )	\$ 38,765	\$ 6,006	\$ 212,881
<b>Liabilities:</b>								
Financial instruments and other inventory positions sold, but not yet purchased:								
Derivative contracts	\$ 5,218	\$(5,873 )	\$ 745	\$ —	\$ —	\$ 5,115	\$ 1,376	\$ 6,581
Total financial instruments and other inventory positions sold, but not yet purchased:	\$ 5,218	\$(5,873 )	\$ 745	\$ —	\$ —	\$ 5,115	\$ 1,376	\$ 6,581

Realized and unrealized gains/(losses) related to financial instruments, with the exception of customer matched-book derivatives, are reported in institutional brokerage on the consolidated statements of operations.

(1) Realized and unrealized gains/(losses) related to customer matched-book derivatives are reported in investment banking. Realized and unrealized gains/(losses) related to investments are reported in investment banking revenues or investment income/(loss) on the consolidated statements of operations.

The carrying values of the Company's cash, securities either purchased or sold under agreements to resell, receivables and payables either from or to customers and brokers, dealers and clearing organizations and short-term financings approximate fair value due to their liquid or short-term nature.

Note 8 Variable Interest Entities

The Company has investments in and/or acts as the managing partner of various partnerships, limited liability companies, or registered mutual funds. These entities were established for the purpose of investing in securities of public or private companies, or municipal debt obligations and were initially financed through the capital commitments or seed investments of the members.

Variable Interest Entities ("VIEs") are entities in which equity investors lack the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities. The determination as to whether an entity is a VIE is based on the amount and nature of the members' equity investment in the entity. The Company also considers other characteristics such as the power through voting rights or similar rights to direct the activities of an entity that most significantly impact the entity's economic performance. For those entities that meet the deferral provisions defined by FASB ASU No. 2010-10, "Consolidation: Amendments for Certain Investment Funds," ("ASU 2010-10"), the Company considers characteristics such as the ability to influence the decision making about the entity's activities and how the entity is financed. The Company has identified certain of the entities described above as VIEs. These VIEs had net assets approximating \$0.7 billion at September 30, 2014 and \$0.8 billion at December 31, 2013. The Company's exposure to loss from these VIEs is \$9.7 million, which is the carrying value of its capital contributions recorded in investments on the consolidated statements of financial condition at September 30, 2014. The Company had no liabilities related to these VIEs at September 30, 2014 and December 31, 2013.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

The Company is required to consolidate all VIEs for which it is considered to be the primary beneficiary. The determination as to whether the Company is considered to be the primary beneficiary is based on whether the Company has both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE. For those entities that meet the deferral provisions defined by ASU 2010-10, the determination as to whether the Company is considered to be the primary beneficiary differs in that it is based on whether the Company will absorb a majority of the VIE's expected losses, receive a majority of the VIE's expected residual returns, or both. The Company determined it is not the primary beneficiary of these VIEs and accordingly does not consolidate them. Furthermore, the Company has not provided financial or other support to these VIEs that it was not previously contractually required to provide as of September 30, 2014.

The Company has investments in a grantor trust which was established as part of a nonqualified deferred compensation plan. The Company is the primary beneficiary of the grantor trust. Accordingly, the assets and liabilities of the grantor trust are consolidated by the Company on the consolidated statements of financial condition. See Note 20 for additional information on the nonqualified deferred compensation plan.

The Company also originates CMOs through secondary market vehicles. The Company's risk of loss with respect to these entities is limited to the fair value of the securities held by the Company.

## Note 9 Receivables from and Payables to Brokers, Dealers and Clearing Organizations

Amounts receivable from brokers, dealers and clearing organizations included:

(Dollars in thousands)	September 30, 2014	December 31, 2013
Receivable arising from unsettled securities transactions	\$ 156,686	\$ 59,657
Deposits paid for securities borrowed	33,310	36,278
Receivable from clearing organizations	14,419	966
Deposits with clearing organizations	33,265	20,995
Securities failed to deliver	17,958	593
Other	35,552	8,624
	\$ 291,190	\$ 127,113

Amounts payable to brokers, dealers and clearing organizations included:

(Dollars in thousands)	September 30, 2014	December 31, 2013
Payable arising from unsettled securities transactions	\$ 63,836	\$ 5,643
Payable to clearing organizations	8,590	9,462
Securities failed to receive	7,101	744
Other	4,817	11,873
	\$ 84,344	\$ 27,722

Deposits paid for securities borrowed approximate the market value of the securities. Securities failed to deliver and receive represent the contract value of securities that have not been delivered or received by the Company on settlement date.

## Note 10 Collateralized Securities Transactions

The Company's financing and customer securities activities involve the Company using securities as collateral. In the event that the counterparty does not meet its contractual obligation to return securities used as collateral (e.g., pursuant to the terms of a repurchase agreement), or customers do not deposit additional securities or cash for margin when required, the Company may be exposed to the risk of reacquiring the securities or selling the securities at unfavorable market prices in order to satisfy its obligations to its customers or counterparties. The Company seeks to control this risk by monitoring the market value of securities pledged or used as collateral on a daily basis and requiring adjustments in the event of excess market exposure. The Company also uses unaffiliated third party custodians to administer the underlying collateral for certain of its repurchase agreements and short-term financing to mitigate risk.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

In a reverse repurchase agreement the Company purchases financial instruments from a seller, typically in exchange for cash, and agrees to resell the same or substantially the same financial instruments to the seller at a stated price plus accrued interest in the future. In a repurchase agreement, the Company sells financial instruments to a buyer, typically for cash, and agrees to repurchase the same or substantially the same financial instruments from the buyer at a stated price plus accrued interest at a future date. Even though repurchase and reverse repurchase agreements involve the legal transfer of ownership of financial instruments, they are accounted for as financing arrangements because they require the financial instruments to be repurchased or resold at maturity of the agreement.

In a securities borrowed transaction, the Company borrows securities from a counterparty in exchange for cash. When the Company returns the securities, the counterparty returns the cash. Interest is generally paid periodically over the life of the transaction.

In the normal course of business, the Company obtains securities purchased under agreements to resell, securities borrowed and margin agreements on terms that permit it to repledge or resell the securities to others, typically pursuant to repurchase agreements. The Company obtained securities with a fair value of approximately \$300.5 million and \$212.4 million at September 30, 2014 and December 31, 2013, respectively, of which \$292.7 million and \$194.9 million, respectively, had been pledged or otherwise transferred to satisfy its commitments under financial instruments and other inventory positions sold, but not yet purchased.

The following is a summary of the Company's securities sold under agreements to repurchase ("Repurchase Liabilities"), the fair market value of collateral pledged and the interest rate charged by the Company's counterparty, which is based on LIBOR plus an applicable margin, as of September 30, 2014:

(Dollars in thousands)	Repurchase Liabilities	Fair Market Value	Interest Rate
Term up to 30 day maturities:			
Asset-backed securities	\$ 11,796	\$ 16,075	1.75 - 1.84%
Term of 30 to 90 day maturities:			
Asset-backed securities	4,665	6,218	1.88%
On demand maturities:			
Corporate securities:			
Fixed income securities	10,907	11,488	0.55%
U.S. government agency securities	39,605	41,501	0.25 - 0.30%
	\$66,973	\$75,282	

Reverse repurchase agreements, repurchase agreements and securities borrowed and loaned are reported on a net basis by counterparty when a legal right of offset exists. There were no gross amounts offset on the consolidated statements of financial condition for reverse repurchase agreements, securities borrowed or repurchase agreements at September 30, 2014 and December 31, 2013, respectively, as a legal right of offset did not exist. The Company had no outstanding securities lending arrangements as of September 30, 2014 or December 31, 2013. See Note 6 for information related to the Company's offsetting of derivative contracts.

For the nine months ended September 30, 2013, the Company revised its consolidated statements of cash flows to reflect a \$36.9 million increase in securities sold under agreements to repurchase from operating activities to financing activities based upon the nature of the repurchase transactions. This change had no effect on net cash for the period presented.



Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

## Note 11 Investments

The Company's proprietary investments include investments in private companies and partnerships, registered mutual funds, warrants of public and private companies and private company debt. Investments included:

(Dollars in thousands)	September 30, 2014	December 31, 2013
Investments at fair value	\$92,173	\$69,930
Investments at cost	7,683	20,709
Investments accounted for under the equity method	25,311	21,404
Total investments	125,167	112,043
Less investments attributable to noncontrolling interests (1)	(30,344 )	(21,137 )
	\$94,823	\$90,906

(1) Noncontrolling interests are attributable to third party ownership in a consolidated merchant banking fund and private equity investment vehicles.

Management regularly reviews the Company's investments in private company debt and has concluded that no valuation allowance is needed as it is probable that all contractual principal and interest will be collected.

At September 30, 2014, investments carried on a cost basis had an estimated fair market value of \$13.0 million. The estimated fair value of these investments was based on an assessment of each underlying security, considering rounds of financing, third-party transactions and market-based information, including comparable company transactions, trading multiples (e.g., multiples of revenue and EBITDA), and changes in market outlook, among other factors. Because valuation estimates were based upon management's judgment, investments carried at cost would be categorized as Level III assets in the fair value hierarchy, if they were carried at fair value.

Investments accounted for under the equity method include general and limited partnership interests. The carrying value of these investments is based on the investment vehicle's net asset value. The net assets of investment partnerships consist of investments in both marketable and non-marketable securities. The underlying investments held by such partnerships are valued based on the estimated fair value determined by management in our capacity as general partner or investor and, in the case of investments in unaffiliated investment partnerships, are based on financial statements prepared by the unaffiliated general partners.

## Note 12 Other Assets

Other assets included:

(Dollars in thousands)	September 30, 2014	December 31, 2013
Net deferred income tax assets	\$37,495	\$36,252
Fee receivables	24,764	34,415
Accrued interest receivables	10,856	9,793
Forgivable loans, net	9,649	7,879
Prepaid expenses	3,697	5,237
Other	9,576	8,516
Total other assets	\$96,037	\$102,092



## Note 13 Goodwill and Intangible Assets

The following table presents the changes in the carrying value of goodwill and intangible assets from continuing operations for the nine months ended September 30, 2014:

(Dollars in thousands)	Capital Markets	Asset Management	Total
Goodwill			
Balance at December 31, 2013	\$13,790	\$196,844	\$210,634
Goodwill acquired	—	—	—
Impairment charge	—	—	—
Measurement period adjustment	1,244	—	1,244
Balance at September 30, 2014	\$15,034	\$196,844	\$211,878
Intangible assets			
Balance at December 31, 2013	\$5,316	\$34,614	\$39,930
Amortization of intangible assets	(2,229)	(4,725)	(6,954)
Balance at September 30, 2014	\$3,087	\$29,889	\$32,976

---

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

## Note 14 Short-Term Financing

The following is a summary of short-term financing and the weighted average interest rate on borrowings:

	Outstanding Balance		Weighted Average Interest Rate		
	September 30, 2014	December 31, 2013	September 30, 2014	December 31, 2013	
(Dollars in thousands)					
Commercial paper (secured)	\$247,795	\$280,294	1.51	% 1.59	%
Prime broker arrangement	—	234,417	N/A	0.90	%
Bank lines (secured)	91,000	—	1.50	%	N/A
Total short-term financing	\$338,795	\$514,711			

The Company issues secured commercial paper to fund a portion of its securities inventory. The commercial paper notes (“CP Notes”) can be issued with maturities of 27 days to 270 days from the date of issuance. The CP Notes are issued under three separate programs, CP Series A, CP Series II A and CP Series III A, and are secured by different inventory classes. As of September 30, 2014, the weighted average maturity of CP Series A, CP Series II A and CP Series III A was 140 days, 200 days and 35 days, respectively. The CP Notes are interest bearing or sold at a discount to par with an interest rate based on LIBOR plus an applicable margin. CP Series III A includes a covenant that requires the Company’s U.S. broker dealer subsidiary to maintain excess net capital of \$120 million.

The Company has established an arrangement to obtain financing with a prime broker related to its municipal bond funds. Financing under this arrangement is secured by certain securities, primarily municipal securities, and collateral limitations could reduce the amount of funding available under this arrangement. The prime broker financing activities are recorded net of receivables from trading activity. The funding is at the discretion of the prime broker subject to a notice period.

The Company has committed short-term bank line financing available on a secured basis and uncommitted short-term bank line financing available on both a secured and unsecured basis. The Company uses these credit facilities in the ordinary course of business to fund a portion of its daily operations and the amount borrowed under these credit facilities varies daily based on the Company’s funding needs.

The Company’s committed short-term bank line financing at September 30, 2014 consisted of a one-year \$250 million committed revolving credit facility with U.S. Bank, N.A., which was renewed in December 2013. Advances under this facility are secured by certain marketable securities. The facility includes a covenant that requires the Company’s U.S. broker dealer subsidiary to maintain minimum net capital of \$120 million, and the unpaid principal amount of all advances under this facility will be due on December 27, 2014. The Company pays a nonrefundable commitment fee on the unused portion of the facility on a quarterly basis. At September 30, 2014, the Company had no advances against this line of credit.

The Company’s uncommitted secured lines at September 30, 2014 totaled \$185 million with two banks and are dependent on having appropriate collateral, as determined by the bank agreement, to secure an advance under the line. The availability of the Company’s uncommitted lines are subject to approval by the individual banks each time an advance is requested and may be denied. At September 30, 2014, the Company had \$91.0 million in advances against these lines of credit.

## Note 15 Variable Rate Senior Notes

On November 30, 2012, the Company entered into a note purchase agreement under which the Company issued unsecured variable rate senior notes ("Notes") in the amount of \$125 million. The initial holders of the Notes are certain entities advised by PIMCO. The Notes consist of two classes, Class A Notes and Class B Notes, with principal amounts of \$50 million and \$75 million, respectively.

On June 2, 2014, the Company entered into an amended and restated note purchase agreement ("Amended Note Purchase Agreement") under which the Company issued \$50 million of new Class A Notes upon repayment in full of the 2012 Class A Notes. The Class A Notes bear interest at a rate equal to three-month LIBOR plus 3.00 percent and mature on May 31, 2017. The Class B Notes remain outstanding, bear interest at a rate equal to three-month LIBOR plus 4.50 percent and mature on November 30, 2015. Interest on the Notes is adjustable and payable quarterly. The unpaid principal amounts are due in full on the respective maturity dates and may not be prepaid by the Company.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

The Amended Note Purchase Agreement includes customary events of default, including failure to pay principal when due or failure to pay interest within five business days of when due, any representation or warranty in the Amended Note Purchase Agreement proving untrue in any material respect when made by the Company, failure to comply with the covenants in the Amended Note Purchase Agreement, failure to pay or another event of default under other material indebtedness in an amount exceeding \$10 million, bankruptcy or insolvency of the Company or any of its subsidiaries or a change in control of the Company. If there is any event of default under the Amended Note Purchase Agreement, the noteholders may declare the entire principal and any accrued interest on the Notes to be due and payable and exercise other customary remedies.

The Amended Note Purchase Agreement includes covenants that, among other things, require the Company to maintain a minimum consolidated tangible net worth and regulatory net capital, limit the Company's leverage ratio and require the Company to maintain a minimum ratio of operating cash flow to fixed charges. With respect to the net capital covenant, the Company's U.S. broker dealer subsidiary is required to maintain minimum net capital of \$120 million. At September 30, 2014, the Company was in compliance with all covenants.

The Notes are recorded at amortized cost. As of September 30, 2014, the carrying value of the Notes approximates fair value.

Note 16 Contingencies and Commitments

Legal Contingencies

The Company has been named as a defendant in various legal actions, including complaints and litigation and arbitration claims, arising from its business activities. Such actions include claims related to securities brokerage and investment banking activities, and certain class actions that primarily allege violations of securities laws and seek unspecified damages, which could be substantial. Also, the Company is involved from time to time in investigations and proceedings by governmental agencies and self-regulatory organizations ("SROs") which could result in adverse judgments, settlement, penalties, fines or other relief.

The Company has established reserves for potential losses that are probable and reasonably estimable that may result from pending and potential legal actions, investigations and regulatory proceedings. In many cases, however, it is inherently difficult to determine whether any loss is probable or even possible or to estimate the amount or range of any potential loss, particularly where proceedings may be in relatively early stages or where plaintiffs are seeking substantial or indeterminate damages. Matters frequently need to be more developed before a loss or range of loss can reasonably be estimated.

Given uncertainties regarding the timing, scope, volume and outcome of pending and potential legal actions, investigations and regulatory proceedings and other factors, the amounts of reserves and ranges of reasonably possible losses are difficult to determine and of necessity subject to future revision. Subject to the foregoing, management of the Company believes, based on currently available information, after consultation with outside legal counsel and taking into account its established reserves, that pending legal actions, investigations and regulatory proceedings will be resolved with no material adverse effect on the consolidated statements of financial condition, results of operations or cash flows of the Company. However, if during any period a potential adverse contingency should become probable or resolved for an amount in excess of the established reserves, the results of operations and cash flows in that period and the financial condition as of the end of that period could be materially adversely affected. In addition, there can be no assurance that material losses will not be incurred from claims that have not yet been brought to the

Company's attention or are not yet determined to be reasonably possible.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

## Operating Lease Commitments

The Company leases office space throughout the United States and in a limited number of foreign countries where the Company's international operations reside. Aggregate minimum lease commitments under operating leases as of September 30, 2014 are as follows:

(Dollars in thousands)

Remainder of 2014	\$2,651
2015	12,244
2016	11,901
2017	9,877
2018	9,563
Thereafter	35,441
	\$81,677

## Note 17 Restructuring

For the nine months ended September 30, 2013, the Company incurred pre-tax restructuring charges of \$2.9 million from continuing operations. The charges resulted from severance benefits of \$2.1 million, \$0.5 million for vacating redundant leased office space and \$0.3 million for contract termination costs.

## Note 18 Shareholders' Equity

## Share Repurchases

In the third quarter of 2012, the Company's board of directors authorized the repurchase of up to \$100.0 million in common shares through September 30, 2014. During the nine months ended September 30, 2014, the Company did not repurchase any shares of the Company's outstanding common stock related to this authorization. The Company also purchases shares of common stock from restricted stock award recipients upon the award vesting as recipients sell shares to meet their employment tax obligations. The Company purchased 251,004 shares or \$10.6 million of the Company's common stock for this purpose during the nine months ended September 30, 2014.

In the third quarter of 2014, the Company's board of directors authorized the repurchase of up to \$100.0 million in common shares through September 30, 2016. This share repurchase authorization became effective on October 1, 2014.

## Issuance of Shares

During the nine months ended September 30, 2014, the Company issued 103,598 common shares out of treasury stock in fulfillment of \$4.2 million in obligations under the Piper Jaffray Companies Retirement Plan (the "Retirement Plan") and issued 635,347 common shares out of treasury stock as a result of employee restricted share vesting and exercise transactions as discussed in Note 20. During the nine months ended September 30, 2013, the Company issued 96,049 common shares out of treasury stock in fulfillment of \$3.9 million in obligations under the Retirement Plan and issued 770,189 common shares out of treasury stock as a result of employee restricted share vesting.



Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

## Note 19 Noncontrolling Interests

The consolidated financial statements include the accounts of Piper Jaffray Companies, its wholly owned subsidiaries and other entities in which the Company has a controlling financial interest. Noncontrolling interests represent equity interests in consolidated entities that are not attributable, either directly or indirectly, to Piper Jaffray Companies. Noncontrolling interests include the minority equity holders' proportionate share of the equity in a municipal bond fund of \$110.4 million, a merchant banking fund of \$22.9 million and private equity investment vehicles aggregating \$7.4 million as of September 30, 2014. As of December 31, 2013, noncontrolling interests included the minority equity holders' proportionate share of the equity in a municipal bond fund of \$126.3 million, a merchant banking fund of \$14.1 million and private equity investment vehicles aggregating \$7.0 million.

Ownership interests in entities held by parties other than the Company's common shareholders are presented as noncontrolling interests within shareholders' equity, separate from the Company's own equity. Revenues, expenses and net income or loss are reported on the consolidated statements of operations on a consolidated basis, which includes amounts attributable to both the Company's common shareholders and noncontrolling interests. Net income or loss is then allocated between the Company and noncontrolling interests based upon their relative ownership interests. Net income applicable to noncontrolling interests is deducted from consolidated net income to determine net income applicable to the Company. There was no other comprehensive income or loss attributed to noncontrolling interests for the nine months ended September 30, 2014 and 2013, respectively.

(Dollars in thousands)	Common Shareholders' Equity	Noncontrolling Interests	Total Shareholders' Equity
Balance at December 31, 2013	\$734,676	\$147,396	\$882,072
Net income	50,629	9,721	60,350
Amortization/issuance of restricted stock	22,114	—	22,114
Issuance of treasury shares for options exercised	3,644	—	3,644
Repurchase of common stock for employee tax withholding	(10,563	) —	(10,563
Issuance of treasury shares for 401k match	4,156	—	4,156
Shares reserved/issued for director compensation	120	—	120
Other comprehensive loss	(143	) —	(143
Fund capital withdrawals, net	—	(16,402	) (16,402
Balance at September 30, 2014	\$804,633	\$140,715	\$945,348

Table of Contents

Piper Jaffray Companies  
Notes to the Consolidated Financial Statements  
(Unaudited)

## Note 20 Compensation Plans

## Stock-Based Compensation Plans

The Company maintains two stock-based compensation plans, the Piper Jaffray Companies Amended and Restated 2003 Annual and Long-Term Incentive Plan (the “Incentive Plan”) and the 2010 Employment Inducement Award Plan (the “Inducement Plan”). The Company’s equity awards are recognized on the consolidated statements of operations at grant date fair value over the service period of the award, net of estimated forfeitures.

The following table provides a summary of the Company’s outstanding equity awards (in shares or units) as of September 30, 2014:

Incentive Plan	
Restricted Stock	
Annual grants	811,513
Sign-on grants	267,651
	1,079,164
Inducement Plan	
Restricted Stock	29,159
Total restricted stock related to compensation	1,108,323
ARI deal consideration (1)	104,496
Total restricted stock outstanding	1,212,819
Incentive Plan	
Restricted Stock Units	
Leadership grants	405,826
Incentive Plan	
Stock options outstanding	261,259

(1) The Company issued restricted stock as part of deal consideration in conjunction with the acquisition of ARI.

## Incentive Plan

The Incentive Plan permits the grant of equity awards, including restricted stock, restricted stock units and non-qualified stock options, to the Company’s employees and directors for up to 7.0 million shares of common stock (1.0 million shares remained available for future issuance under the Incentive Plan as of September 30, 2014). The Company believes that such awards help align the interests of employees and directors with those of shareholders and serve as an employee retention tool. The Incentive Plan provides for accelerated vesting of awards if there is a severance event, a change in control of the Company (as defined in the Incentive Plan), in the event of a participant’s death, and at the discretion of the compensation committee of the Company’s board of directors.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

Restricted Stock Awards

Restricted stock grants are valued at the market price of the Company's common stock on the date of grant and are amortized over the related requisite service period. The Company grants shares of restricted stock to current employees as part of year-end compensation ("Annual Grants") and as a retention tool. Employees may receive restricted stock upon initial hiring or as a retention award ("Sign-on Grants").

The Company's Annual Grants are made each year in February. Annual Grants vest ratably over three years in equal installments. The Annual Grants provide for continued vesting after termination of employment, so long as the employee does not violate certain post-termination restrictions set forth in the award agreement or any agreements entered into upon termination. The Company determined the service inception date precedes the grant date for the Annual Grants, and that the post-termination restrictions do not meet the criteria for an in-substance service condition, as defined by FASB Accounting Standards Codification Topic 718, "Compensation – Stock Compensation" ("ASC 718"). Accordingly, restricted stock granted as part of the Annual Grants is expensed in the one-year period in which those awards are deemed to be earned, which is generally the calendar year preceding the February grant date. For example, the Company recognized compensation expense during fiscal 2013 for its February 2014 Annual Grant. If an equity award related to the Annual Grants is forfeited as a result of violating the post-termination restrictions, the lower of the fair value of the award at grant date or the fair value of the award at the date of forfeiture is recorded within the consolidated statements of operations as a reversal of compensation expense.

Sign-on Grants are used as a recruiting tool for new employees and are issued to current employees as a retention tool. These awards have both cliff and ratable vesting terms, and the employees must fulfill service requirements in exchange for rights to the awards. Compensation expense is amortized on a straight-line basis from the grant date over the requisite service period, generally two to five years. Employees forfeit unvested shares upon termination of employment and a reversal of compensation expense is recorded.

Annually, the Company grants stock to its non-employee directors. The stock-based compensation paid to non-employee directors is fully expensed on the grant date and included within outside services expense on the consolidated statements of operations.

Restricted Stock Units

The Company granted annual restricted stock units to its leadership team ("Leadership Grants") beginning in May 2012. The units will vest and convert to shares of common stock at the end of each 36-month performance period only if the Company satisfies predetermined market conditions over the performance period. Under the terms of the grants, the number of units that will vest and convert to shares will be based on the Company achieving specified market conditions during each performance period as described below. Compensation expense is amortized on a straight-line basis over the three-year requisite service period based on the fair value of the award on the grant date. The market condition must be met for the awards to vest and compensation cost will be recognized regardless if the market condition is satisfied. Employees forfeit unvested share units upon termination of employment with a corresponding reversal of compensation expense.

Up to 50 percent of the award can be earned based on the Company's total shareholder return relative to members of a predetermined peer group and up to 50 percent of the award can be earned based on the Company's total shareholder return. The fair value of the awards on the grant date were determined using a Monte Carlo simulation with the following assumptions:

Grant Year	Risk-free Interest Rate	Expected Stock Price Volatility
2014	0.82%	41.3%
2013	0.40%	44.0%
2012	0.38%	47.6%

Because a portion of the award vesting depends on the Company's total shareholder return relative to a peer group, the valuation modeled the performance of the peer group as well as the correlation between the Company and the peer group. The expected stock price volatility assumptions were determined using historical volatility as correlation coefficients can only be developed through historical volatility. The risk-free interest rates were determined based on three-year U.S. Treasury bond yields.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

## Stock Options

The Company previously granted options to purchase Piper Jaffray Companies common stock to employees and non-employee directors in fiscal years 2004 through 2008. Employee and director options were expensed by the Company on a straight-line basis over the required service period, based on the estimated fair value of the award on the date of grant using a Black-Scholes option-pricing model. As described above pertaining to the Company's Annual Grants of restricted shares, stock options granted to employees were expensed in the calendar year preceding the annual February grant date. For example, the Company recognized compensation expense during fiscal 2007 for its February 2008 option grant. The maximum term of the stock options granted to employees and directors is ten years. The Company has not granted stock options since 2008.

## Inducement Plan

In 2010, the Company established the Inducement Plan in conjunction with the acquisition of ARI. The Company granted \$7.0 million in restricted stock (158,801 shares) under the Inducement Plan to ARI employees upon closing of the transaction. These shares vest ratably over five years in equal annual installments ending on March 1, 2015. Inducement Plan awards are amortized as compensation expense on a straight-line basis over the vesting period. Employees forfeit unvested Inducement Plan shares upon termination of employment and a reversal of compensation expense is recorded.

## Stock-Based Compensation Activity

The Company recorded total compensation expense within continuing operations of \$7.2 million and \$6.0 million for the three months ended September 30, 2014 and 2013, respectively, and \$20.5 million and \$10.4 million for the nine months ended September 30, 2014 and 2013, respectively, related to employee restricted stock and restricted stock unit awards. Total compensation cost includes year-end compensation for Annual Grants and the amortization of Sign-on Grants, less forfeitures of \$0.5 million and \$0.1 million for the three months ended September 30, 2014 and 2013, respectively, and \$0.6 million and \$0.8 million for the nine months ended September 30, 2014 and 2013, respectively. The tax benefit related to stock-based compensation costs totaled \$2.8 million and \$2.3 million for the three months ended September 30, 2014 and 2013, respectively, and \$8.0 million and \$4.0 million for the nine months ended September 30, 2014 and 2013, respectively.

The following table summarizes the changes in the Company's unvested restricted stock (including the unvested restricted stock issued as part of the deal consideration for ARI) under the Incentive Plan and Inducement Plan for the nine months ended September 30, 2014:

	Unvested Restricted Stock (in Shares)	Weighted Average Grant Date Fair Value
December 31, 2013	1,582,062	\$35.25
Granted	415,413	40.34
Vested	(765,283)	) 35.17
Canceled	(19,373)	) 36.19
September 30, 2014	1,212,819	\$37.03

The following summarizes the changes in the Company's unvested restricted stock units under the Incentive Plan for the nine months ended September 30, 2014:

Edgar Filing: PIPER JAFFRAY COMPANIES - Form 10-Q

	Unvested Restricted Stock Units	Weighted Average Grant Date Fair Value
December 31, 2013	290,536	\$15.83
Granted	115,290	23.42
Vested	—	—
Canceled	—	—
September 30, 2014	405,826	\$17.99

As of September 30, 2014, there was \$11.5 million of total unrecognized compensation cost related to restricted stock and restricted stock units expected to be recognized over a weighted average period of 2.5 years.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

The following table summarizes the changes in the Company's outstanding stock options for the nine months ended September 30, 2014:

	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value
December 31, 2013	469,289	\$ 44.83	2.0	\$ 288,318
Granted	—	—		
Exercised	(94,478 )	38.57		
Canceled	(55 )	39.62		
Expired	(113,497 )	47.72		
September 30, 2014	261,259	\$ 45.83	2.0	\$ 2,527,750
Options exercisable at September 30, 2014	261,259	\$ 45.83	2.0	\$ 2,527,750

As of September 30, 2014, there was no unrecognized compensation cost related to stock options expected to be recognized over future years.

The intrinsic value of options exercised and the resulting tax benefit realized was \$1.1 million and \$0.4 million, respectively, for the nine months ended September 30, 2014. There were no options exercised for the nine months ended September 30, 2013.

## Deferred Compensation Plans

In 2013, the Company adopted a nonqualified deferred compensation plan, an unfunded plan which allows certain highly compensated employees, at their election, to defer a percentage of their base salary, commissions and/or cash bonuses. The deferrals vest immediately and are non-forfeitable. The amounts deferred under this plan are held in a grantor trust. The Company invests, as a principal, in investments to economically hedge its obligation under the nonqualified deferred compensation plan. Investments in the grantor trust, consisting of mutual funds, totaled \$6.5 million as of September 30, 2014, and are included in investments on the consolidated statements of financial condition. The compensation deferred by the employees is expensed in the period earned. The deferred compensation liability was \$6.5 million as of September 30, 2014. Changes in the fair value of the investments made by the Company are reported in investment income/(loss) and changes in the corresponding deferred compensation liability are reflected as compensation and benefits expenses on the consolidated statements of operations.

In 2012, the Company established the Piper Jaffray Companies Mutual Fund Restricted Share Investment Plan, a deferred compensation plan which allows eligible employees to elect to receive a portion of the incentive compensation they would otherwise receive in the form of restricted stock, instead in MFRS Awards of registered funds managed by the Company's asset management business. MFRS Awards are awarded to qualifying employees in February of each year, and represent a portion of their compensation for performance in the preceding year similar to the Company's Annual Grants. MFRS Awards vest ratably over three years in equal installments and provide for continued vesting after termination of employment so long as the employee does not violate certain post-termination restrictions set forth in the award agreement or any agreement entered into upon termination. Forfeitures are recorded as a reduction of compensation and benefits expense within the consolidated statements of operations.

The Company has also granted MFRS Awards to new employees as a recruiting tool. Employees must fulfill service requirements in exchange for rights to the awards. Compensation expense from these awards will be amortized on a straight-line basis over the requisite service period of two to five years.

Table of Contents

Piper Jaffray Companies

Notes to the Consolidated Financial Statements

(Unaudited)

## Note 21 Earnings Per Share

The Company calculates earnings per share using the two-class method. Basic earnings per common share is computed by dividing net income/(loss) applicable to Piper Jaffray Companies' common shareholders by the weighted average number of common shares outstanding for the period. Net income/(loss) applicable to Piper Jaffray Companies' common shareholders represents net income/(loss) applicable to Piper Jaffray Companies reduced by the allocation of earnings to participating securities. Losses are not allocated to participating securities. All of the Company's unvested restricted shares are deemed to be participating securities as they are eligible to share in the profits (e.g., receive dividends) of the Company. The Company's unvested restricted stock units are not participating securities as they are not eligible to share in the profits of the Company. Diluted earnings per common share is calculated by adjusting the weighted average outstanding shares to assume conversion of all potentially dilutive stock options.

The computation of earnings per share is as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
(Amounts in thousands, except per share data)				
Net income from continuing operations applicable to Piper Jaffray Companies	\$14,668	\$6,851	\$50,629	\$21,877
Net loss from discontinued operations	—	(1,529)	—	(3,921)
Net income applicable to Piper Jaffray Companies	14,668	5,322	50,629	17,956
Earnings allocated to participating securities (1)	(1,116)	(496)	(4,243)	(1,793)
Net income applicable to Piper Jaffray Companies' common shareholders (2)	\$13,552	\$4,826	\$46,386	\$16,163

Shares for basic and diluted calculations:

Average shares used in basic computation	15,066	14,621	14,880	15,271
Stock options	63	5	54	13
Average shares used in diluted computation	15,129	14,626	14,934	15,284

Earnings/(loss) per basic common share:

Income from continuing operations	\$0.90	\$0.42	\$3.12	\$1.29
Loss from discontinued operations	—	(0.09)	—	(0.23)
Earnings per basic common share	\$0.90	\$0.33	\$3.12	\$1.06

Earnings/(loss) per diluted common share:

Income from continuing operations	\$0.90	\$0.42	\$3.11	\$1.29
Loss from discontinued operations	—	(0.09)	—	(0.23)
Earnings				