CYTOGEN CORP
Form 10-Q
August 14, 2003

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2003

OR

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

For the transition period from ---------- to ----------

Commission file number 000-14879

Cytogen Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware	22-2322400
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

650 College Road East, Suite 3100, Princeton, NJ 08540-5308
(Address of Principal Executive Offices and Zip Code)

Registrant's Telephone Number, Including Area Code: (609) 750-8200

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Outstanding at August 1, 2003

Common Stock, $.01 par value 11,040,846

CYTOGEN CORPORATION

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PART I - FINANCIAL INFORMATION

ITEM 1 - CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

CYTOGEN CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(ALL AMOUNTS IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)
(UNAUDITED)

	JUNE 30, 2003	DECEMB 20
ASSETS:		
Current Assets:		
Cash and cash equivalents	$ 13,529	$ 14
Accounts receivable, net	1,290	1
Inventories	2,029	1
Other current assets	632	
Total current assets	17,480	18
Property and Equipment, net	783	1
Other Assets	703	
	$ 18,966	$ 19
LIABILITIES AND STOCKHOLDERS' EQUITY:		

Current Liabilities:		
Current portion of long-term liabilities	$ 75	$
Accounts payable and accrued liabilities	3,839	4
Deferred revenue	323	
Total current liabilities	4,237	4
Long-Term Liabilities	2,535	2
Deferred Revenue	1,670	1
Stockholders' Equity:		
Preferred stock, $.01 par value, 5,400,000 shares authorized - Series C Junior Participating Preferred Stock, $.01 par value, 200,000 shares authorized, none issued and outstanding	-	
Common stock, $.01 par value, 25,000,000 shares authorized, 9,818,756 and 8,758,235 shares issued and outstanding at June 30, 2003 and December 31, 2002, respectively	99	
Additional paid-in capital	372,126	366
Deferred compensation	(2)	
Accumulated deficit	(361,699)	(356
Total stockholders' equity	10,524	10
	$ 18,966	$ 19

The accompanying notes are an integral part of these statements.

CYTOGEN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(ALL AMOUNTS IN THOUSANDS, EXCEPT PER SHARE DATA)
(UNAUDITED)

	THREE MONTHS ENDED JUNE 30,		EN
	2003	2002	2003
REVENUES:			
Product related:			
ProstaScint	$ 1,599	$ 1,971	$ 3,21
BrachySeed	-	565	24
Others	98	56	12
Total product sales	1,697	2,592	3,58

Quadramet royalties	465	510	91
Total product related	2,162	3,102	4,49
License and contract	164	65	30
Total revenues	2,326	3,167	4,80
OPERATING EXPENSES:			
Cost of product related revenues	900	1,241	1,81
Research and development	771	1,746	1,60
Equity loss in PSMA LLC	1,086	595	1,96
Selling and marketing	1,174	1,622	2,47
General and administrative	1,740	1,200	2,81
Total operating expenses	5,671	6,404	10,67
Operating loss	(3,345)	(3,237)	(5,86
INTEREST INCOME	23	72	5
INTEREST EXPENSE	(46)	(42)	(9
Loss before income taxes	(3,368)	(3,207)	(5,90
INCOME TAX BENEFIT	-	-	(58
NET LOSS	$(3,368)	$(3,207)	$ (5,31
BASIC AND DILUTED NET LOSS PER SHARE	$ (0.37)	$ (0.39)	$ (0.6
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING	9,051	8,308	8,90

The accompanying notes are an integral part of these statements.

CYTOGEN CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(ALL AMOUNTS IN THOUSANDS)
(UNAUDITED)

SIX MONTHS ENDED JUNE 30,

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	$(5,319)	$(8,205)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	306	407
Stock-based compensation expenses	502	747
Amortization of deferred revenue	(192)	(280)
Stock-based milestone payment	-	2,000
Changes in assets and liabilities:		
Receivables, net	488	872
Inventories	(767)	518
Other assets	(293)	(511)
Accounts payable and accrued liabilities	(574)	(462)
Net cash used in operating activities	(5,849)	(4,914)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of product rights	-	(500)
Net proceeds from sale of equipment	-	100
Purchases of property and equipment	(2)	(24)
Net cash used in investing activities	(2)	(424)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	4,739	12,980
Payment of long-term liabilities	(84)	(49)
Net cash provided by financing activities	4,655	12,931
Net increase (decrease) in cash and cash equivalents......	(1,196)	7,593
Cash and cash equivalents, beginning of period	14,725	11,309
Cash and cash equivalents, end of period	$ 13,529	$ 18,902

The accompanying notes are an integral part of these statements.

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CYTOGEN CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

1. THE COMPANY

BACKGROUND

Cytogen Corporation ("Cytogen" or the "Company") of Princeton, New

Jersey is a product-driven, oncology-focused biopharmaceutical company. Cytogen markets proprietary and licensed oncology products through its in-house specialty sales force: Quadrdamet(R) (a skeletal targeting therapeutic radiopharmaceutical for the relief of pain due to bone metastases); ProstaScint(R) (A monoclonal antibody-based imaging agent used to image the extent and spread of prostate cancer), and NMP22 BladderChek(TM) (a point-of-care, in vitro diagnostic test for bladder cancer). The Company's pipeline is comprised of product candidates at various stages of clinical development, including fully human monoclonal antibodies and cancer vaccines based on PSMA prostate specific membrane antigen technology, or PSMA technologies, which Cytogen exclusively licensed from Memorial Sloan-Kettering Cancer Center. Cytogen also conducts research in cellular signaling through its subsidiary, AxCell Biosciences.

In addition to the products listed above, in August 2000, Cytogen expanded its product pipeline by entering into marketing, license and supply agreements with Advanced Magnetics, Inc. for Combidex(R), which is an investigational magnetic resonance imaginG (MRI) contrast agent that assists in the differentiation of metastatic from non-metastatic lymph nodes. Cytogen holds exclusive United States marketing rights to Combidex. Advanced Magnetics is continuing its discussions with the FDA relating to outstanding issues regarding an approvable letter received from the FDA in June 2000, in an effort to bring Combidex to market.

Cytogen has had a history of operating losses since its inception. Although the Company continually looks to expand its product pipeline, the Company currently relies on two products. ProstaScint and Quadramet, for substantially all of its revenues. In addition, the Company has, from time to time, ceased sales of certain products, such as BrachySeed and OncoScint CR/OV, that the Company previously believed would generate significant revenues for its business. The Company's products are subject to significant regulatory review by the FDA and other federal and state agencies, which requires significant time and expenditures in seeking product approvals. In addition, the Company relies on collaborative partners to a significant degree to manufacture its products, to secure raw materials, and to provide licensing rights to their proprietary products for the Company to sell and market to others.

BASIS OF CONSOLIDATION

The consolidated financial statements include the accounts of Cytogen and its subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

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BASIS OF PRESENTATION

The consolidated financial statements and notes thereto of Cytogen are unaudited and include all adjustments, which in the opinion of management, are necessary to present fairly the financial condition and results of operations as of and for the periods set forth in the Consolidated Balance Sheets, Consolidated Statements of Operations and Consolidated Statements of Cash Flows. All such accounting adjustments are of a normal, recurring nature. The consolidated financial statements do not include all of the information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America and should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K, as amended, filed with the Securities and Exchange Commission, which includes financial statements as of and for the year ended December 31, 2002. The results of the Company's operations for any interim period are not

necessarily indicative of the results of the Company's operations for any other interim period or for a full year.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, cash in banks and all highly-liquid investments with a maturity of three months or less at the time of purchase.

INVENTORIES

The Company's inventories are primarily related to ProstaScint and NMP22 BladderChek. Inventories are stated at the lower of cost or market using the first-in, first-out method and consisted of the following:

	June 30, 2003	December 31, 2002
Raw materials....................	$ 39,000	$ 506,000
Work-in process..................	1,695,000	39,000
Finished goods...................	295,000	717,000
	$ 2,029,000	$ 1,262,000

NET LOSS PER SHARE

Basic net loss per common share is based upon the weighted average common shares outstanding during each period. Diluted net loss per common share is the same as basic net loss per share, as the inclusion of common stock equivalents would be antidilutive due to the Company's losses.

OTHER COMPREHENSIVE LOSS

Other comprehensive loss consisted of an unrealized loss on a marketable security. For the three and six months ended June 30, 2002, the fair market value of that security decreased $223,000 and $539,000, respectively, and

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as a result, the comprehensive loss for the three and six months ended June 30, 2002 was $3,430,000 and $8,744,000, respectively. There were no marketable securities outstanding during the first half of 2003 and therefore no other comprehensive gains or losses.

STOCK-BASED COMPENSATION

The Company follows the intrinsic value method of accounting for stock-based employee compensation in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees", and related interpretations. The Company records deferred compensation for option grants to employees for the amount, if any, by which the market price per share exceeds the exercise price per share at the measurement date, which is generally the grant date.

The Company follows the disclosure provisions of Statement of Financial Accounting Standards (SFAS) 123 "Accounting for Stock-Based Compensation", as amended by SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." Had compensation cost for options been recognized in the consolidated statements of operations using the fair value method of accounting, the Company's net loss and net loss per share would have been:

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS E[NDED] JUNE 30	
	2003	2002	2003	
Net loss, as reported	$ (3,368,000)	$ (3,207,000)	$ (5,319,000)	$
Add: Stock-based employee compensation expense included in reported net loss	-	203,000	1,000	
Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards	(361,000)	(885,000)	(712,000)	
Pro forma net loss	$ (3,729,000)	$ (3,889,000)	$ (6,030,000)	$
Basic and diluted net loss per share, as reported	$ (0.37)	$ (0.39)	$ (0.60)	$
Pro forma basic and diluted net loss per share	$ (0.41)	(0.47)	$ (0.68)	$

2. EQUITY LOSS IN PSMA DEVELOPMENT CO. LLC

In June 1999, Cytogen entered into a joint venture with Progenics Pharmaceuticals Inc. ("Progenics", and collectively with Cytogen, the "Members"), the PSMA Development Company LLC, (the "Joint Venture"), to develop vaccine and antibody-based immunotherapeutic products utilizing Cytogen's exclusively licensed PSMA technology. The Joint Venture is owned equally by Cytogen and Progenics.

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The Company accounts for the Joint Venture using the equity method of accounting. Through November 2001, Progenics was obligated to fund the initial $3.0 million of the development costs. Beginning in December 2001, Cytogen began to recognize 50% of the Joint Venture's operating results in its consolidated statements of operations. The Joint Venture is expected to continue to incur losses in future years. For the three months ended June 30, 2003 and 2002, Cytogen recognized $1,086,000 and $595,000, respectively, of such losses. For the six months ended June 30, 2003 and 2002, Cytogen recognized $1,966,000 and $1,108,000, respectively, of such losses. As of June 30, 2003 and December 31, 2002, the carrying value of the Company's investment in the Joint Venture was $286,000 and $1,000, respectively, which represents Cytogen's investment to date in the Joint Venture, less its cumulative share of losses, which net investment is recorded in other assets. Selected financial statement information of the Joint Venture is as follows:

	JUNE 30, 2003	DECEMBER 31, 2002

Balance Sheet Data:

Cash	$ 925,000	$ 290,000
Accounts payable......................	$ 371,000	$ 304,000
Capital contributions.................	15,898,000	11,399,000
Accumulated deficit...................	(15,344,000)	(11,413,000)
	$ 925,000	$ 290,000

	THREE MONTHS ENDED JUNE 30,		SIX MONTHS ENDED JUNE 30,		FOR THE PERIOD FROM JUNE 15, 1999 (INCEPTION) TO JUNE 30, 2003
	2003	2002	2003	2002	
Interest income....	$ 1,000	$ 4,000	$ 1,000	$ 4,000	$ 230,000
Total expenses.....	2,173,000	1,193,000	3,932,000	2,220,000	15,574,000
Net loss	$(2,172,000)	$(1,189,000)	$(3,931,000)	$(2,216,000)	$(15,344,000)

In July 2003, the Members agreed to: (i) an updated work plan governing the activities of the Joint Venture for the remainder of 2003, including the execution of various third-party contracts; (ii) a budget for the Joint Venture's operations for 2003 and related capital contributions of the parties; and (iii) an amended services agreement pursuant to which the Members will provide research and development and related services for the remainder of 2003. The Company is committed to contribute an additional $1.8 million to the joint venture through the end of 2003. The Joint Venture's work plan, budget, and other operational and financial matters relating to periods after 2003 will require the further agreement of the Members.

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3. LITIGATION

On March 17, 2000, Cytogen was served with a complaint filed against the Company in the U.S. District Court for the District of New Jersey by M. David Goldenberg ("Goldenberg") and Immunomedics, Inc. (collectively "Plaintiffs"). The litigation claims that ProstaScint infringes a patent purportedly owned by Goldenberg and licensed to Immunomedics. The Company believes that ProstaScint does not infringe this patent, and that the patent is invalid and unenforceable. The patent sought to be enforced in the litigation has now expired; as a result, the claim even if successful would not result in an injunction barring the continued sale of ProstaScint or affect any other of Cytogen's products or technology. In addition, the Company has certain rights to indemnification against litigation and litigation expenses from the inventor of technology used in ProstaScint, which may be offset against royalty payments on sales of ProstaScint. On December 17, 2001, Cytogen filed a motion for summary

judgment of non-infringement of the asserted claims of the patent-in-suit. The Plaintiffs opposed that motion and filed their own cross-motion for summary judgment of infringement. On July 3, 2002, the Court denied both parties' summary judgment motions, with leave to renew those motions after hearing expert testimony and legal argument based upon that testimony. On April 29, 2003, Cytogen's motion for summary judgment of non-infringement of all asserted claims was granted, plantiff's motion for summary judgment of infringement was denied and the case was ordered closed. On May 12, 2003, Plaintiffs filed a Notice of Appeal regarding this decision to the U.S. Court of Appeals for the Federal Circuit, and subsequently filed their opening brief in the Court of Appeals for the Federal Circuit on July 28, 2003.

4. INCOME TAXES

During the first quarter of 2003, the Company sold New Jersey State net operating loss and research and development credit carryforwards, which resulted in the recognition of $584,000 of income tax benefit. This benefit has been recognized, as the sale has been approved by the necessary New Jersey state authorities, and the Company has completed the sale with a qualified buyer.

5. SALES OF COMMON STOCK

In June 2003, the Company entered into a securities purchase agreement pursuant to which the Company sold 1,052,632 shares of its common stock to certain institutional investors at $4.75 per share, resulting in net proceeds of approximately $4.7 million. In connection with the sale, the Company issued to the investors warrants to purchase 315,790 shares of its common stock with an exercise price of $6.91 per share. The warrants are exercisable until June 6, 2008.

In July 2003, the Company entered into a securities purchase agreement pursuant to which the Company sold 1,172,332 shares of its common stock to certain institutional investors at $8.53 per share, resulting in net proceeds of approximately $9.4 million. In connection with the sale, the Company issued to the investors warrants to purchase 1,172,332 shares of its common stock with an exercise price of $12.80 per share. In addition, the Company also issued: (i) warrants to purchase 100,000 shares of its common stock at an exercise price of $12.80 per share to a consultant as part of its compensation for services rendered in connection with this financing; and (ii) warrants to purchase an aggregate of 250,000 shares of its common stock at an exercise price of $10.97

per share to certain of our stockholders in exchange for them waiving certain rights in connection with this financing. The warrants are exercisable until July 10, 2008 and become automatically exercised, in full, if (i) the closing price of the Company's common stock (or in case no sales are reported on any given trading day, the average of the closing bid and asked prices of the Company's common stock on the NASDAQ National Market for such trading day) is at least 130% of the exercise price then in effect for 30 consecutive trading days, and (ii) a registration statement to register such shares of common stock to be issued upon such exercise has been declared effective by the Securities and Exchange Commission. Upon receipt of written notice by the Company of such automatic exercise, the holders of the warrants must purchase all of the shares of common stock underlying their respective warrants by paying the Company the exercise price times the number of shares of common stock issuable upon exercise.

6. REACQUISITION OF QUADRAMET

In June 2003, the Company announced that it had entered into an agreement with Berlex to reacquire marketing rights to Quadramet in North

America and Latin America in exchange for an upfront payment of $8.0 million and royalties based on future sales of Quadramet, subject to Cytogen obtaining any necessary financing for the reacquisition. The agreement with Berlex became effective August 1, 2003. Accordingly, effective August 1, 2003, we began recording all revenue from the sales of Quadramet. We will no longer receive royalty revenue.

7. MANUFACTURING COMMITMENT

In August 2003, the Company completed the reacquisition of the marketing rights to Quadramet from Berlex. As a result, the Company has assumed certain additional obligations under a Manufacturing and Supply Agreement with Bristol Meyers Squibb, including an obligation to pay manufacturing costs of at least $3.7 million annually through 2005. Such obligation for the remainder of 2003 is approximately $1.5 million.

8. WARRANTS ISSUED TO CONSULTANTS

In June 2003, the Company issued to consultants warrants to purchase an aggregate of 100,000 shares of the Company's common stock at an exercise price of $5.65 per share for consulting services. The warrants are exercisable in 12 equal installments on each one-month anniversary from the date of issuance and are exercisable through June 10, 2006. The Company recorded the fair value of these warrants, in the amount of $497,000, in its statement of operations for the second quarter of 2003 using the Black-Scholes pricing model.

9. STOCK OPTION PLANS

At the Company's 2003 Annual Meeting of Stockholders held on June 10, 2003, the stockholders of the Company approved a proposal to amend the Company's 1995 Stock Option Plan (the "1995 Stock Option Plan") to increase the maximum number of shares of the Company's Common Stock available for issuance thereunder from 450,263 to 650,263 shares and to reserve an additional 200,000 shares of the Company's Common Stock for issuance in connection with such increase for awards to be granted under the 1995 Stock Option Plan.

ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934, as amended. All statements, other than statements of historical facts, included in this Quarterly Report on Form 10-Q regarding our strategy, future operations, financial position, future revenues, projected costs, prospects, plans and objectives of management are forward-looking statements. The words "anticipates," "believes," "estimates," "expects," "intends," "may," "plans," "projects," "will," "would" and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Such forward-looking statements involve a number of risks and uncertainties and investors are cautioned not to put any undue reliance on any forward-looking statement. We cannot guarantee that we will actually achieve the plans, intentions or expectations disclosed in any such forward-looking statements. Risk factors that could cause actual results to differ materially include those identified in our Annual Report on Form 10-K for the year ended December 31, 2002, as amended, under the caption "Additional Factors That May Affect Future Results" and those under the caption "Risk Factors", as included in certain of

our other filings, from time to time, with the Securities and Exchange Commission. Investors are cautioned not to put undue reliance on any forward-looking statement. Any forward-looking statements made by us do not reflect the potential impact of any future acquisitions, mergers, dispositions, joint ventures or investments we may make. We do not assume, and specifically disclaim, any obligation to update any forward-looking statements, and these statements represent our current outlook only as of the date they are made.

The following discussion and analysis should be read in conjunction with the Financial Statements and related notes thereto contained elsewhere herein, as well as in our Annual Report on Form 10-K for the year ended December 31, 2002, as amended, and from time to time in our other filings with the Securities and Exchange Commission.

SIGNIFICANT EVENTS IN 2003

In January 2003, we provided Draximage Inc. with notice of termination of each of our License and Distribution Agreement and Product Manufacturing and Supply Agreement with respect to both of Draximage's BrachySeed I-125 and BrachySeed Pd-103 products. Effective January 24, 2003, we no longer accept or fill new orders for the BrachySeed products. In April 2003, we entered into an agreement with Draximage formally terminating each of these agreements.

In April 2003, NMP22 BladderChek was awarded clearance from the FDA for use in diagnosing patients for bladder cancer, in addition to approval gained previously for the indication of monitoring patients who have a prior diagnosis of bladder cancer. We are in the early-phase of launching NMP22 BladderChek and are promoting the product to urologists in the United States using our in-house sales force.

In June 2003, we entered into a securities purchase agreement with certain institutional investors pursuant to which we issued and sold 1,052,632 shares of our common stock at $4.75 per share. In connection with such

financing, we also issued warrants to such investors to purchase 315,790 shares of our common stock with an exercise price of $6.91 per share. The warrants are exercisable until June 6, 2008. The aggregate net proceeds received from this financing of approximately $4.7 million after transaction costs are expected to be used for general corporate purposes, marketing and sales initiatives for our oncology products and development of our prostate specific membrane antigen (PSMA) technology.

In June 2003, we announced that, subject to obtaining the necessary finacing, we entered into an agreement with Berlex Laboratories, a U.S. affiliate of Schering AG, Germany, referred to as Berlex Laboratories, whereby marketing rights held by Berlex Laboratories to market Quadramet (Samarium Sm 153 Lexidronam), a skeletal targeting therapeutic radiapharmaceutical for the relief pain due to bone metastases arising from prostate, breast, multiple myeloma and other types of cancer, in North America and Latin America were to be returned to us in exchange for an upfront payment of $8.0 million and royalties based on future sales. Effective August 1, 2003, we have reacquired from Berlex Laboratories the marketing rights to Quadramet and paid to Berlex Laboratories the upfront payment of $8.0 million. Accordingly, effective as of August 1, 2003, we began recording all revenue from the sales of Quadramet. We will no longer receive royalty revenue.

In June 2003, we announced that we had formed a partnership with Siemens Medical Solutions and the University Hospitals of Cleveland to promote advances in prostate cancer imaging. Through this partnership, physicians at the

University Hospitals of Cleveland will be using Siemens e.cam(TM) gamma camera with Flash 3D iterative reconstruction and CT attenuation correction technologY, in combination with our ProstaScint imaging agent. The resulting images may provide improvements for the diagnosis and staging of metastatic prostate cancer. Also in June 2003, we announced the formation of an alliance with GE Medical Systems, a unit of General Electric Company, to market a total molecular imaging system to help evaluate the extent and spread of prostate cancer by integrating GE Medical's Infinia(TM) Hawkeye(R) imaging system with our ProstaScint imaging agent. We cannot assure you that these partnerships ANd alliances will be successful in increasing ProstaScint revenue, or that such increase, if any, will be significant.

In July 2003, we entered into a securities purchase agreement pursuant to which we sold 1,172,332 shares of our common stock to certain institutional investors at $8.53 per share, resulting in net proceeds of approximately $9.4 million. In connection with the sale, we issued to such investors warrants to purchase 1,172,332 shares of our common stock with an exercise price of $12.80 per share. In addition, we also issued: (i) warrants to purchase 100,000 shares of our common stock at an exercise price of $12.80 per share to a consultant as part of its compensation for services rendered in connection with this financing; and (ii) warrants to purchase an aggregate of 250,000 shares of our common stock at an exercise price of $10.97 per share to certain of our stockholders in exchange for them waiving certain rights in connection with this financing. The warrants are exercisable until July 10, 2008 and become automatically exercised, in full, if (i) the closing price of the our common stock (or in case no sales are reported on any given trading day, the average of the closing bid and asked prices of our common stock on the NASDAQ National Market for such trading day) is at least 130% of the exercise price then in effect for 30 consecutive trading days, and (ii) a registration statement to register such shares of common stock to be issued upon such exercise has been

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declared effective by the Securities and Exchange Commission. Upon receipt of written notice by us of such automatic exercise, the holders of the warrants must purchase all of the shares of common stock underlying their respective warrants by paying us the exercise price times the number of shares of common stock issuable upon exercise. The net proceeds from this financing were used in our reacquisition of certain marketing rights from Berlex and related expenses.

In July 2003, in connection with our joint venture with Progenics Pharmaceuticals, Inc., we and Progenics agreed to: (i) an updated work plan governing the activities of the joint venture for the remainder of 2003, including the execution of various third-party contracts; (ii) a budget for the joint venture's operations for 2003 and related capital contributions of the parties; and (iii) an amended services agreement pursuant to which each party to the joint venture will provide research and development and related services for the remainder of 2003. The joint venture work plan, budget, and other operational and financial matters relating to periods after 2003 will require the further agreement between us and Progenics.

In August 2003, we paid to Berlex Laboratories the upfront payment of $8.0 million and have reacquired from Berlex Laboratories the marketing rights to Quadramet. Accordingly, effective as of August 1, 2003, we began recording all revenue from the sales of Quadramet.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2003 AND 2002

REVENUES. Total revenues for the second quarter of 2003 were $2.3

million compared to $3.2 million for the same period in 2002. The decrease from the prior year period is due primarily to lower product related revenues. Product related revenues, which included product sales and royalties, accounted for 93% and 98% of total revenues for the second quarters of 2003 and 2002, respectively. License and contract revenues accounted for the remainder of revenues.

Product related revenues for the second quarter of 2003 were $2.2 million compared to $3.1 million for the same period in 2002. Sales of ProstaScint accounted for 74% and 64% of product related revenues in the second quarters of 2003 and 2002, respectively, while Quadramet royalties accounted for 22% and 16% of product related revenues for such quarters, respectively. Sales of ProstaScint were $1.6 million for the second quarter of 2003, a decrease of $372,000 from $2.0 million in the second quarter of 2002. Such decrease in sales of ProstaScint may be due, in part, to the tendency of radiopharmacy wholesalers, during times of economic downturn, to order high-priced drugs, such as ProstaScint, on an as-needed basis, and no longer store quantities for future use. Additionally, ProstaScint historically has been a challenging product for physicians and technologists to use, in part because imaging results may be difficult to interpret. While we believe that the period to period decrease in ProstaScint sales that we have experienced is due, to a large degree, to such challenge, we also believe that such decline in ProstaScint revenue may be reversed depending upon, among other things, the implementation and continued research relating to the following:

- Advances in imaging technology:

    - Fusion imaging - an image processing technique that combines functional information from a ProstaScint scan with anatomic images provided by CT (computed tomography) or MR (magnetic resonance) scans in a digital overlay to provide information that cannot be achieved with separate imaging modalities alone, which may improve diagnostic interpretation; and

    - Image enhancements - improving the quality of ProstaScint images through reconstruction and attenuation-correction methods to address inherent limitations of single photon emission computed tomography (SPECT) imaging by correcting for the effects of radiation scatter and/or inherent collimator/detector blur.

- New product applications:

    - Utilization of ProstaScint scans to guide therapy ("image-guided therapy"), to enhance therapy targeting for treatments such as brachytherapy, cryotherapy and external beam radiation, such as intensity modulated radiation therapy (IMRT); and

    - Utilization of ProstaScint scans to guide biopsy ("image-guided biopsy"), which could be facilitated by future advances in image acquisition technology.

There can be no assurance, however, that the achievement of any of the above will significantly increase our sales of ProstaScint.

Revenues from the sale of BrachySeed during the second quarter of 2002 were $565,000, which represented 18% of product related revenues in the second quarter of 2002. As described above, effective January 24, 2003, we no longer accept or fill new orders for the BrachySeed I-125 and BrachySeed Pd-103

products. In April 2003, we entered into an agreement with Draximage to formally terminate our agreements with respect to these products.

Other product sales include sales from NMP22 BladderChek, which we began promoting to urologists in the United States in November 2002 using our in-house sales force, and OncoScint CR/OV which we stopped selling in December 2002. During the second quarter 2003, sales of NMP22 BladderChek were $98,000. NMP22 BladderChek is one of only two immunoassay fluid tests approved by the FDA for diagnosing patients for cancer; the other is the prostate specific antigen (PSA) test for prostate cancer. The NMP22 BladderChek test is currently approved for use in two clinical settings:

- Monitoring - In July 2002, NMP22 BladderChek was approved by FDA for monitoring patients previously diagnosed with bladder cancer; and

- Diagnosis - In April 2003, NMP22 BladderChek was approved by FDA to aid in the diagnosis of patients with bladder cancer.

There can be no assurance however, as to the market acceptance of NMP22 BladderChek or whether sale of NMP22 BladderChek will significantly increase our revenues.

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We discontinued selling OncoScint CR/OV in December 2002 in order to focus on our other oncology products, since the market for OncoScint CR/OV for colorectal cancer diagnosis has been negatively affected by positron emission tomography or "PET" scans which have shown the same or higher sensitivity than OncoScint CR/OV. Sales of OncoScint CR/OV during the second quarter of 2002 were $56,000.

Quadramet royalties for the second quarter of 2003 were $465,000, a decrease of $45,000 from $510,000 in the second quarter of 2002. Through July 31, 2003, Quadramet was marketed in the United States by our marketing partner, Berlex Laboratories. In June 2003, we entered into an agreement with Berlex Laboratories whereby marketing rights held by Berlex Laboratories to market Quadramet in North America and Latin America were to be returned to us in exchange for an upfront payment of $8.0 million and royalties based on future sales. On August 1, 2003, we reacquired such rights from Berlex Laboratories and began to market Quadramet through an in-house specialty sales force. We believe that the period to period decrease in such sales was attributable, in part, to the transition of marketing rights from Berlex to Cytogen. Currently, we market Quadramet only in the United States. Schering AG, Germany which acquired CIS Bio International in 2000 will continue to market Quadramet in Europe as a direct licensee of Dow Chemical Company. We cannot assure you that we will be able to successfully market Quadramet or that any such sales will result in further revenue for us in the future. We believe that the future growth and market penetration of Quadramet is dependent upon, among other things:

- New clinical data supporting the expanded and earlier use of Quadramet in various cancers;
- Novel research supporting combination uses with other therapies, such as chemotherapy and bisphophonates;
- Establishing the use of Quadramet at higher doses to target and treat primary bone cancers; and
- Increased marketing and sales penetration to physicians.

There can be no assurance that Quadramet will achieve greater market penetration on a timely basis or result in significant revenues for us.

License and contract revenues for the second quarter of 2003 were

$164,000 compared to $65,000 for the same period of 2002. As a result of our adoption of Securities and Exchange Commission's Staff Accounting Bulletin No.101 (referred to as SAB 101) in 2000, license revenues from certain up-front, non-refundable license fees previously recognized in prior years were deferred and are being amortized over the estimated performance period. In the second quarter of 2003, we recognized $96,000 of deferred license revenue compared to $65,000 for the same period in 2002. In the second quarter of 2003, we recorded $53,000 of contract revenues for research and development services provided by us to the PSMA Development Company LLC, our joint venture with Progenics Pharmaceuticals Inc. The level of future revenues for the remainder of 2003, if any, for contract services provided to the joint venture will be dependent upon the extent of the research and development services required by the joint venture.

OPERATING EXPENSES. Total operating expenses for the second quarter of 2003 were $5.7 million compared to $6.4 million in the same quarter of 2002. The decrease from the prior year period is attributable primarily to lower costs of

product sales and lower selling and marketing expenses due to our discontinuation of selling and marketing BrachySeed products in January 2003 and cost-saving measures implemented in September 2002 as a result of a restructuring at our subsidiary AxCell Biosciences. The decrease is partially offset by increased funding for our joint venture and increased general and administrative expenses primarily from a non-cash charge related to warrants granted to certain consultants in 2003.

Cost of product related revenues for the second quarter of 2003 were $900,000 compared to $1.2 million in the same period of 2002. The decrease from the prior year period is substantially due to lower product sales, primarily, the discontinuation of selling and marketing of BrachySeed products in January 2003.

Research and development expenses for the second quarter of 2003 were $771,000 compared to $1.7 million in the same period of 2002. The decrease from the prior year period is attributable primarily to cost-saving measures implemented in September 2002 as a result of a restructuring at our subsidiary AxCell Biosciences and development efforts in the amount of $352,000 in 2002, which did not recur in 2003, related to the new manufacturing and purification process for ProstaScint. During the second quarters of 2003 and 2002, we invested $357,000 and $1.0 million, respectively, in AxCell's signal transduction research activities.

Our share in the equity loss in the PSMA Development Company LLC, our joint venture with Progenics Pharmaceuticals, Inc. was $1.1 million during the second quarter of 2003 compared to $595,000 in the same quarter of 2002 and represented 50% of the joint venture's operating results. The joint venture is equally owned by us and Progenics. We account for the joint venture using the equity method of accounting. We share equally with Progenics the costs of the joint venture. We expect to incur significant and increasing costs in the future to fund our share of the development costs from the joint venture. On July 14, 2003, we agreed with Progenics, in connection with the joint venture: (i) to an updated work plan governing the activities of the joint venture for the remainder of 2003, including the execution of various third-party contracts; (ii) to a budget for the joint venture's operations for 2003 and related capital contributions of the parties; and (iii) to an amended services agreement pursuant to which each party to the joint venture will provide research and development and related services for the remainder of 2003. The joint venture's work plan, budget, and other operational and financial matters relating to periods after 2003 will require the further agreement between us and Progenics.

There can be no assurances made that such further agreements will be reached.

Selling and marketing expenses for the second quarter of 2003 were $1.2 million compared to $1.6 million in the same period of 2002. The decrease from the prior year is primarily due to the discontinuation of the selling and marketing activities related to the BrachySeed products effective January 2003.

General and administrative expenses for the second quarter of 2003 were $1.7 million compared to $1.2 million in the same period of 2002. The increase from the prior year period is primarily due to stock based compensation expenses related to warrants granted to certain consultants, partially offset by lower compensation expenses due to reduced staffing.

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INTEREST INCOME/EXPENSE. Interest income for the second quarter of 2003 was $23,000 compared to $72,000 in the same period of 2002. The decrease from the prior year period is due to a lower average yield on investments and lower average cash balances in 2003. Interest expense for the second quarter of 2003 was $46,000 compared to $42,000 in the same period of 2002. Interest expense includes interest on outstanding debt and finance charges related to various equipment leases.

NET LOSS. Net loss for the second quarter of 2003 was $3.4 million compared to $3.2 million reported in the second quarter of 2002. The net loss per share for the second quarter of 2003 was $0.37 based on weighted average common shares outstanding of 9.1 million, compared to a net loss per share of $0.39 based on weighted average common shares outstanding of 8.3 million for the same period in 2002.

SIX MONTHS ENDED JUNE 30, 2003 AND 2002

REVENUES. Total revenues for the first half of 2003 and 2002 were $4.8 million and $6.5 million, respectively. The decrease from the prior year period is due primarily to lower product related revenues and royalties. Product related revenues, which included product sales and royalties, accounted for 94% of total revenues in the first half of 2003 compared to 96% from the comparable period of 2002. License and contract revenues accounted for the remainder of revenues.

Product related revenues for the first half of 2003 and 2002 were $4.5 million and $6.2 million, respectively. Sales of ProstaScint accounted for 72% and 65% of product related revenues in the first half of 2003 and 2002, respectively, while Quadramet royalties accounted for 20% and 16% of product related revenues for such periods, respectively. Sales of ProstaScint were $3.2 million for the first half of 2003 compared to $4.0 million for the first half of 2002. Such decrease in sales of ProstaScint may be due, in part, to the tendency of radiopharmacy wholesalers, during times of economic downturn, to order high-priced drugs, such as ProstaScint, on an as-needed basis, and no longer store quantities for future use. Additionally, ProstaScint historically has been a challenging product for physicians and technologists to use, in part because imaging results may be difficult to interpret. While we believe that the period to period decrease in ProstaScint sales that we have experienced is due, to a large degree, to such challenge, we also believe that such decline in ProstaScint revenue may be reversed, depending upon, among other things, the implementation and continued research in advances in imaging technology such as fusion imaging and image enhancements, and new product applications, such as using ProstaScint scans to guide the placement of brachytherapy seeds and/or external beam radiation. There can be no assurance, however, that such initiatives will significantly increase our sales of ProstaScint.

Royalties from Quadramet were $914,000 and $1.0 million for each of the first half of 2003 and 2002, respectively. We completed the reacquisition of marketing rights to Quadramet from Berlex Laboratories, Inc. on August 1, 2003 for an upfront payment of $8.0 million and royalties on future sales. We believe that the decrease in such sales was attributable in part to the transition of marketing rights from Berlex to Cytogen. Currently, we market Quadramet only in the United States. We cannot assure you that that we will be able to successfully market Quadramet or that our marketing efforts will result in further revenue for us in the future.

Revenues from the sale of BrachySeed for the first half of 2003 were $240,000, or 5% of product related revenue, compared to $1.0 million in BrachySeed sales which represented 16% of product related revenues recorded in the same period of 2002. As described above, effective January 24, 2003, we no longer accept or fill new orders for the BrachSeed I-125 and BrachySeed Pd-103 products. In April 2003, we entered into an arrangement with Draximage to formally terminate our agreements with respect to these products.

Other product sales include sales from NMP22 BladderChek, which we began promoting to urologists in the United States in November 2002 using our in-house sales force, and OncoScint CR/OV, which we stopped selling in December 2002. For the first half of 2003, sales of NMP22 BladderChek were $123,000. There can be no assurance however, as to the market acceptance of NMP22 BladderChek or whether sales of NMP22 BladderChek will significantly increase our revenues.

We discontinued selling OncoScint CR/OV in December 2002 in order to focus on our other oncology products, since the market for OncoScint CR/OV for colorectal cancer diagnosis has been negatively affected by positron emission tomography or "PET" scans which have shown the same or higher sensitivity than OncoScint CR/OV. Sales of OncoScint CR/OV in the first half of 2002 were $110,000.

License and contract revenues for the first half of 2003 and 2002 were $307,000 and $280,000, respectively. In the first half of 2003, we performed limited research and development services for the joint venture, resulting in $100,000 of contract revenue. The level of future revenue for the remainder of 2003, if any, for services provided by us to the joint venture will be dependent upon the extent of the research and development services required by the joint venture. License revenues for both 2003 and 2002 also include the recognition of deferred revenues from certain up-front non-refundable license fees which were $193,000 and $280,000, respectively.

OPERATING EXPENSES. Total operating expenses for the first half of 2003 were $10.7 million compared to $14.7 million recorded in 2002. The decrease from the prior year period is attributable primarily to a non-cash milestone expense of $2.0 million in 2002 related to the progress of the dendritic cell prostate cancer clinical trials at Northwest Biotherapeutics, decreases in research and development expenditures relating to AxCell Biosciences, the development cost of $583,000 incurred in 2002 relating to a new manufacturing and purification process for ProstaScint, and lower cost of product sales and selling and marketing expenses primarily from the discontinuation of selling and marketing BrachySeed products in January 2003. The decrease is partially offset by increased development costs associated with our joint venture.

Cost of product related revenues for the first half of 2003 were $1.8 million compared to $2.3 million in the same period of 2002. The decrease from the prior year period is primarily due to the lower product sales and to a reversal of $133,000 related to lower royalty expenses on the 2002 BrachySeed

sales as a result of a termination agreement entered into with Draximage with respect to the BrachySeed products.

Research and development expenses for the first half of 2003 were $1.6 million compared to $5.5 million recorded in the same period of 2002. The decrease from the prior year period is attributable primarily to a non-cash milestone expense of $2.0 million in 2002 related to the progress of dendritic cell prostate cancer clinical trials at Northwest Biotherapeutics, decreased costs associated with the AxCell's research programs and the development cost of $583,000 in 2002, which did not recur in 2003, relating to a new manufacturing and purification process for ProstaScint. During the first six months of 2003 and 2002, we invested $807,000 and $2.3 million, respectively, in AxCell's subsidiary. In September 2002, we significantly reduced AxCell's workforce to reduce the cash expenditures relating to AxCell in order to leverage our oncology franchise. We still conduct research and development efforts through AxCell, however, such efforts have been scaled back as a result of the workforce reduction.

Our share in the equity loss in the PSMA Development Company LLC, our joint venture with Progenics Pharmaceuticals, Inc., was $2.0 million and $1.1 million during the first half of 2003 and 2002, respectively, and represented 50% of the joint venture's operating results. The joint venture is equally owned by us and Progenics and we account for this joint venture using the equity method of accounting. We share equally with Progenics the costs associated with the joint venture. We expect to incur significant and increasing costs in the future to fund our share of the development costs from the joint venture.

Selling and marketing expenses were $2.5 million for the first half of 2003 compared to $3.1 million in the same period of 2002. The decrease from the prior year period is due to the discontinuation of selling and marketing activities relating to BrachySeed products in January 2003.

General and administrative expenses for the first half of 2003 were $2.8 million compared to $2.7 million for the comparable period in 2002. Such increase was due primarily to increased legal fees and stock based compensation expenses related to warrants granted to certain consultants in 2003, partially offset by stock-based compensation charges in 2002 relating to options granted to a key employee, and reduced staffing in 2003.

INTEREST INCOME/EXPENSE. Interest income for the first half of 2003 was $59,000 compared to $149,000 recorded in the same period of 2002. The decrease from the prior year period is due a lower average yield on investments and a lower average cash balance in 2003. Interest expense for the first half of 2003 was $93,000 compared to $84,000 recorded in the same period of 2002. Interest expense included interest on outstanding debt and finance charges related with various equipment leases.

INCOME TAX BENEFIT. During the first quarter of 2003, we sold New Jersey State net operating loss and research and development credit carryforwards, which resulted in the recognition of a $584,000 income tax benefit. Assuming the State of New Jersey continues to fund this program, which is uncertain, the future amount of net operating losses and tax credits which we may sell will also depend upon the allocation among qualifying companies of an annual pool established by the State of New Jersey. We did not recognize any such benefits during the first half of 2002.

NET LOSS. Net loss for the first half of 2003 was $5.3 million compared to $8.2 million recorded in the same period of 2002. The net loss per share for the first half of 2003 was $0.60 based on weighted average common shares outstanding of 8.9 million compared to a net loss per share of $1.00 based on the weighted average common shares outstanding of 8.2 million for the same period in 2002.

LIQUIDITY AND CAPITAL RESOURCES

Our cash and cash equivalents were $13.5 million as of June 30, 2003, compared to $14.7 million as of December 31, 2002. Cash used for operating activities for the six months ended June 30, 2003 was $5.8 million compared to $4.9 million in the same period of 2002. The increase from the prior year period is due primarily to our build-up of ProstaScint inventories in the first half of 2003 and to our increased capital contributions to the PSMA Development Company, LLC, our joint venture with Progenics Pharmaceuticals, Inc.

Historically, our primary sources of cash have been proceeds from the issuance and sale of our stock through public offerings and private placements, product related revenues, revenues from contract research services, fees paid under license agreements and interest earned on cash and short-term investments.

In January 2003, we received $584,000 relating to a sale of New Jersey State net operating losses and research and development credits. Assuming the State of New Jersey continues to fund this program, which is uncertain, the future amount of net operating losses and tax credits which we may sell will also depend upon the allocation among qualifying companies of an annual pool established by the State of New Jersey.

In June 2003, we entered into a securities purchase agreement with certain institutional investors pursuant to which we issued and sold 1,052,632 shares of our common stock at $4.75 per share. In connection with such financing, we also issued warrants to such investors to purchase 315,790 shares of the our common stock with an exercise price of $6.91 per share. The warrants are exercisable until June 6, 2008. The aggregate net proceeds received by us after transaction costs was approximately $4.7 million.

In July 2003, we sold to the certain institutional investors 1,172,332 shares of our common stock and warrants to purchase an additional 1,172,332 shares of our common stock for aggregate net proceeds received by us of approximately $9.4 million after transaction costs. The warrants to purchase the shares of our common stock have an exercise price of $12.80 per share. The warrants are exercisable until July 10, 2008 and become automatically exercised, in full, if (i) the closing price of the our common stock (or in case no sales are reported on any given trading day, the average of the closing bid and asked prices of our common stock on the NASDAQ National Market for such trading day) is at least 130% of the exercise price then in effect for 30 consecutive trading days, and (ii) a registration statement to register such shares of common stock to be issued upon such exercise has been declared effective by the Securities and Exchange Commission. In addition, we also issued: (i) warrants to purchase 100,000 shares of our common stock at an exercise price of $12.80 per share to a consultant as part of its compensation for services rendered in connection with this financing; and (ii) warrants to purchase an aggregate of 250,000 shares of

our common stock at an exercise price of $10.97 per share to certain of our stockholders in exchange for them waving certain rights in connection with this financing. On August 1, 2003, $8.0 million of the proceeds from this financing were used to pay for the reacquisition of marketing rights to Quadramet in North

and Latin America from Berlex Laboratories, Inc.

In August 2003, we completed the reacquisition of the marketing rights to Quadramet from Berlex. As a result, we have assumed certain additional obligations under our Manufacturing and Supply Agreement with Bristol Meyers Squibb, including an obligation to pay manufacturing costs of at least $3.7 million annually through 2005. Such obligation for the remainder of 2003 is approximately $1.5 million.

We have historically relied upon revenues from sales of the BrachySeed products to partially fund ongoing operations. For the six months ended June 30, 2003 and 2002, revenue from the sale of BrachySeed products was $240,000 and $1.0 million, respectively. In December 2002, we served notice of termination of our agreements with Draximage, and in April 2003, entered into an agreement with Draximage to formally terminate each of our License and Distribution Agreement and Product Manufacturing and Supply Agreement with respect to both the BrachySeed I-125 and BrachySeed Pd-103 products. As of January 24, 2003, we no longer accept or fill new orders for the BrachySeed products.

Beginning in December 2001, we began to equally share the costs of the joint venture with Progenics. We expect our share of losses and funding in the joint venture to continue at an even higher level in the subsequent periods. We are committed to contribute an additional $1.8 million to the joint venture by the end of 2003. The joint venture is funded by equal capital contributions from each of Progenics and Cytogen in accordance with an annual budget approved by the joint venture's management committee. On July 14, 2003, we agreed with Progenics, in connection with this joint venture: (i) to an updated work plan governing the activities of the joint venture for the remainder of 2003, including the execution of various third-party contracts; (ii) to a budget for the joint venture's operations for 2003 and related capital contributions of the parties; and (iii) to an amended services agreement pursuant to which each party to the joint venture will provide research, development and related services for the remainder of 2003. The joint venture work plan, budget, and other operational and financial matters relating to periods after 2003 will require the further agreement between us and Progenics.

Our capital and operating requirements may change depending upon various factors, including: (i) whether we and our strategic partners achieve success in manufacturing, marketing and commercialization of our products; (ii) the amount of resources which we devote to clinical evaluations and the expansion of marketing and sales capabilities; (iii) results of clinical trials and research and development activities; and (iv) competitive and technological developments, in particular, we expect to incur significant costs for the development of our PSMA technologies.

Our financial objectives are to meet our capital and operating requirements through revenues from existing products and licensing arrangements. To achieve our strategic objectives, we may enter into research and development partnerships and acquire, in-license and develop other technologies, products or

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services. Certain of these strategies may require payments by us in either cash or stock in addition to the costs associated with developing and marketing a product or technology. However, we believe that, if successful, such strategies may increase long-term revenues. There can be no assurance as to the success of such strategies or that resulting funds will be sufficient to meet cash requirements until product revenues are sufficient to cover operating expenses, if ever. To fund these strategic and operating activities, we may sell equity or debt securities as market conditions permit or enter into credit facilities.

We have incurred negative cash flows from operations since our inception, and have expended, and expect to continue to expend in the future, substantial funds to implement our planned product development efforts, including acquisition of products and complementary technologies, research and development, clinical studies and regulatory activities, and to further our marketing and sales programs. We expect that our existing capital resources should be adequate to fund our operations and commitments into the second half of 2004. We cannot assure you that our business or operations will not change in a manner that would consume available resources more rapidly than anticipated. We expect that we will have additional requirements for debt or equity capital, irrespective of whether and when we reach profitability, for further product development costs, product and technology acquisition costs, and working capital.

Our future capital requirements and the adequacy of available funds will depend on numerous factors, including: (i) the successful commercialization of our products; (ii) the costs associated with the acquisition of complementary products and technologies; (iii) progress in our product development efforts and the magnitude and scope of such efforts; (iv) progress with clinical trials; (v) progress with regulatory affairs activities; (vi) the cost of filing, prosecuting, defending and enforcing patent claims and other intellectual property rights; (vii) competing technological and market developments; and (viii) the expansion of strategic alliances for the sales, marketing, manufacturing and distribution of our products. To the extent that the currently available funds and revenues are insufficient to meet current or planned operating requirements, we will be required to obtain additional funds through equity or debt financing, strategic alliances with corporate partners and others, or through other sources. There can be no assurance that the financial sources described above will be available when needed or at terms commercially acceptable to us. If adequate funds are not available, we may be required to delay, further scale back or eliminate certain aspects of our operations or attempt to obtain funds through arrangements with collaborative partners or others that may require us to relinquish rights to certain of our technologies, product candidates, products or potential markets. If adequate funds are not available, our business, financial condition and results of operations will be materially and adversely affected.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Financial Reporting Release No. 60 requires all companies to include a discussion of critical accounting policies or methods used in the preparation of financial statements. Note 1 to our Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2002, as amended, includes a summary of our significant accounting policies and methods used in the preparation of our Consolidated Financial Statements. The following is a brief discussion of the more significant accounting policies and methods used by

us. The preparation of our Consolidated Financial Statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Our actual results could differ materially from those estimates.

REVENUE RECOGNITION

We recognize revenue from the sale of our products upon shipment, which is when title and risk of loss passes to our customers. We do not grant price protection to customers. We recognize Quadramet royalty revenue on Quadramet

sales made by our marketing partner, Berlex, during each period as Berlex sells the product. The Securities and Exchange Commission has issued Staff Accounting Bulletin (SAB) No. 101, "Revenue Recognition", which provides guidance on the recognition of up-front, non-refundable license fees. Accordingly, we defer up-front license fees and recognize them over the estimated performance period of the related agreement, when we have continuing involvement. Since the term of the performance periods is subject to management's estimates, future revenues to be recognized could be affected by changes in such estimates.

ACCOUNTS RECEIVABLE

Our accounts receivable balances are net of an estimated allowance for uncollectible accounts. We continuously monitor collections and payments from our customers and maintain an allowance for uncollectible accounts based upon our historical experience and any specific customer collection issues that we have identified. While we believe our reserve estimate to be appropriate, we may find it necessary to adjust our allowance for uncollectible accounts if the future bad debt expense exceeds our estimated reserve. We are subject to concentration risks as a limited number of our customers provide a high percent of total revenues, and corresponding receivables.

INVENTORIES

Inventories are stated at the lower of cost or market, as determined using the first-in, first-out method, which most closely reflects the physical flow of our inventories. Our products and raw materials are subject to expiration dating. We regularly review quantities on hand to determine the need for reserves for excess and obsolete inventories based primarily on our estimated forecast of product sales. Our estimate of future product demand may prove to be inaccurate, in which case we may have understated or overstated our reserve for excess and obsolete inventories.

CARRYING VALUE OF FIXED AND INTANGIBLE ASSETS

Our fixed assets and certain of our acquired rights to market our products have been recorded at cost and are being amortized on a straight-line basis over the estimated useful life of those assets. If indicators of impairment exist, we assess the recoverability of the affected long-lived assets by determining whether the carrying value of such assets can be recovered through undiscounted future operating cash flows. If impairment is indicated, we measure the amount of such impairment by comparing the carrying value of the

assets to the present value of the expected future cash flows associated with the use of the asset. Adverse changes regarding future cash flows to be received from long-lived assets could indicate that an impairment exists, and would require the write down of the carrying value of the impaired asset at that time.

In October 2002, we entered into a five-year agreement with Matritech Inc. to be the sole distributor for Matritech's NMP22 BladderChek point-of-care test to urologists and oncologists in the United States. Retention of exclusivity rights depends upon meeting certain minimum annual purchases. We paid Matritech $150,000 upon the execution of the agreement, which was recorded as other assets in the accompanying consolidated balance sheet for the respective period and is being amortized over the five year estimated performance period of the agreement.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We do not have operations subject to risks of foreign currency

fluctuations, nor do we use derivative financial instruments in our operations or investment portfolio. As of June 30, 2003, we had $2.3 million of debt outstanding with a fixed interest rate of 7%. We do not have exposure to market risks associated with changes in interest rates, as we have no variable interest rate debt outstanding. Changes in interest rates could expose us to market risk associated with a fixed interest rate debt. We do not believe that this debt will have material exposure to market risks associated with interest rates.

ITEM 4 - CONTROLS AND PROCEDURES

(a) Evaluation of disclosure controls and procedures. Our management, with the participation of our chief executive officer and principal accounting officer, evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of June 30, 2003. In designing and evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applied its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on this evaluation, our chief executive officer and principal accounting officer concluded that as of June 30, 2003, our disclosure controls and procedures were (1) designed to ensure that material information relating to us, including our consolidated subsidiaries, is made known to our chief executive officer and principal accounting officer by others within those entities, particularly during the period in which this report was being prepared and (2) effective, in that they provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

(b) Changes in internal controls. No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the fiscal quarter ended June 30, 2003 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II - OTHER INFORMATION

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

Financings

JUNE 6, 2003 FINANCING

On June 6, 2003, we entered into a securities purchase agreement with certain institutional investors pursuant to which we issued and sold 1,052,632 shares of our common stock at $4.75 per share and issued warrants to purchase 315,790 shares of the our common stock with an exercise price of $6.91 per share. The warrants are exercisable until June 6, 2008. The aggregate net proceeds received by us was approximately $4.7 million after transaction costs. We paid a $200,000 finder's fee in connection with this financing. The aggregate net proceeds received from this financing are expected to be used for general corporate purposes, marketing and sales initiatives for our oncology products and development of our prostate specific membrane antigen (PSMA) technology.

In addition, we entered into registration rights agreements with the investors in this financing. Pursuant to the registration rights agreement, we filed a registration statement on Form S-3 with the Securities and Exchange Commission on July 3, 2003 to register all of the shares of our common stock

issued to the investors and all of the shares to be issued to the investors upon exercise of such warrants. The registration statement has not yet been declared effective by the Securities and Exchange Commission.

No underwriter was employed by us in connection with the issuance of the securities described above. We believe that the issuance of the foregoing securities was exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, as transactions not involving a public offering. Each of the recipients acquired the securities for investment purposes only and not with a view to distribution and had adequate information about us.

JULY 10, 2003 FINANCING

In July 2003, we entered into a securities purchase agreement pursuant to which we sold 1,172,332 shares of our common stock to certain institutional investors at $8.53 per share, resulting in net proceeds of approximately $9.4 million. In connection with the sale, we issued to the investors warrants to purchase 1,172,332 shares of our common stock with an exercise price of $12.80 per share. In addition, we also issued: (i) warrants to purchase 100,000 shares of our common stock at an exercise price of $12.80 per share to a consultant as part of its compensation for services rendered in connection with this financing; and (ii) warrants to purchase an aggregate of 250,000 shares of our common stock at an exercise price of $10.97 per share to certain of our stockholders in exchange for them waiving certain rights in connection with this financing. The warrants are exercisable until July 10, 2008 and become automatically exercised, in full, if (i) the closing price of the our common stock (or in case no sales are reported on any given trading day, the average of the closing bid and asked prices of our common stock on the NASDAQ National Market for such trading day) is at least 130% of the exercise price then in effect for 30 consecutive trading days, and (ii) a registration statement to

register such shares of common stock to be issued upon such exercise has been declared effective by the Securities and Exchange Commission. Upon receipt of written notice by us of such automatic exercise, the holders of the warrants must purchase all of the shares of common stock underlying their respective warrants by paying us the exercise price times the number of shares of common stock issuable upon exercise. Furthermore, we paid a consultant $500,000 as part of its compensation for consulting services that it rendered in this financing. On August 1, 2003, $8.0 million of such proceeds received by us from this financing was used to make an upfront payment to reacquire the marketing rights to Quadramet from Berlex Laboratories, Inc.

In addition, we entered into registration rights agreements with the investors in this financing. Pursuant to the registration rights agreement, we are required to register all of such shares of our common stock issued to the investors and all of the shares to be issued to the investors upon exercise of such warrants. We have not yet filed this registration statement with the Securities and Exchange Commission.

No underwriter was employed by us in connection with the issuance of the securities described above. We believe that the issuance of the foregoing securities was exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, as transactions not involving a public offering. Each of the recipients acquired the securities for investment purposes only and not with a view to distribution and had adequate information about us.

WARRANTS ISSUED TO CONSULTANTS

On June 10, 2003, we issued to a consultant a warrant to purchase

50,000 shares of our common stock at an exercise price of $5.65 per share for financial and strategic consulting services. The warrants are exercisable in 12 equal installments on each one-month anniversary from the date of issuance and are exercisable through June 10, 2006.

On June 10, 2003, we issued to another consultant a warrant to purchase 50,000 shares of our common stock at an exercise price of $5.65 per share for scientific consulting services. The warrants are exercisable in 12 equal installments on each one-month anniversary from the date of issuance and are exercisable through June 10, 2006.

No underwriter was employed by us in connection with the issuance of the warrants described above. We believe that the issuance of the foregoing warrants was exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, as transactions not involving a public offering. Each of the recipients acquired the securities for investment purposes only and not with a view to distribution and had adequate information about us.

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

On June 10, 2003, we held our annual meeting of stockholders to: (i) elect eight directors; (ii) consider and vote upon a proposal to amend, as required, our 1995 Stock Option Plan to increase the maximum aggregate number of shares of common stock available for issuance thereunder from 450,263 to 650,263, and to reserve an additional 200,000 shares of our common stock for issuance in connection with such increase; and (iii) transact such other business as may come before the meeting.

There were represented at the our annual meeting, either in person or by proxy 8,082,162 shares of our common stock out of a total number of 8,813,832 shares of common stock issued and outstanding and entitled to vote at the meeting.

The following tables set forth information regarding the number of votes cast for, withheld, abstentions and broker non-votes, with respect to each matter presented at the meeting. Under the rules of the Nasdaq Stock Market, brokers who hold shares in street name for customers who are beneficial owners of those shares may be prohibited from giving a proxy to vote shares held for such customers on certain matters without specific instructions from such customers (broker non-votes). Under Delaware law, abstentions and broker non-votes are counted as shares represented at the meeting for purposes of determining the presence or absence of a quorum at a stockholders meeting. The election of directors is decided by a plurality of the votes cast, and therefore, votes that are withheld have no effect on the outcome of the vote. Adoption of the proposal relating to our 1995 Stock Option Plan required the affirmative vote of a majority of shares cast at the meeting. Therefore, abstentions and broker non-votes have no effect on the vote.

(i) Election of Directors:

NOMINEES	FOR	WITHHELD	ABSTENTIONS	BROKER NON-VOTES

James A. Grigsby	7,892,250	189,912	N/A	N/A
Michael D. Becker	6,452,622	1,629,540	N/A	N/A
John E. Bagalay, Jr.	6,393,758	1,688,404	N/A	N/A
Allen Bloom	7,946,916	135,246	N/A	N/A
Stephen K. Carter	7,947,411	134,751	N/A	N/A
Robert F. Hendrickson	7,946,973	135,189	N/A	N/A
Kevin G. Lokay	6,454,962	1,627,200	N/A	N/A
H. Joseph Reiser	7,860,936	201,226	N/A	N/A

(ii) Proposal to amend our 1995 Stock Option Plan to increase the maximum number of shares of common stock available for issuance thereunder from 450,263 to 650,263 shares and to reserve an additional 200,000 shares of common stock for issuance in connection with such increase for awards to be granted under the 1995 Stock Option Plan:

FOR	WITHHELD	ABSTENTIONS	BROKER NON-VOTES
7,699,815	347,187	35,160	N/A

ITEM 5. OTHER INFORMATION

One June 10, 2003, we entered into Change of Control Severance Agreements, in the form we utilize with our executive officers, with each of Ms. Thu A. Dang, our Vice President, Finance and Ms. Rita Auld, our Vice President, Human Resources and Administration.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Exhibits:

Exhibit No.	Description
3.1	Bylaws of Cytogen Corporation, as amended. Filed as an exhibit to our Quarterly Report on Form 10-Q for the three-months ended March 31, 2003, as filed with the Securities and Exchange Commission on May 14, 2003, and incorporated herein by reference.
10.1	Securities Purchase Agreement by and among Cytogen Corporation and the Purchasers (as defined therein) dated June 6, 2003. Filed as an exhibit to our Current Report on Form 8-K, dated June 6,

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Exhibit No.	Description
	2003, filed with the Securities and Exchange Commission on June 9, 2003, and incorporated herein by reference.
10.2	Form of Common Stock Purchase Warrant issued by Cytogen Corporation in favor of each Purchaser (as defined therein) dated June 6, 2003. Filed as an exhibit to our Current Report on Form

8-K, dated June 6, 2003, filed with the Securities and Exchange Commission on June 9, 2003, and incorporated herein by reference.

10.3 Registration Rights Agreement by and among Cytogen Corporation and the Purchasers dated June 6, 2003. Filed as an exhibit to our Current Report on Form 8-K, dated June 6, 2003, filed with the Securities and Exchange Commission on June 9, 2003, and incorporated herein by reference.

10.4 Securities Purchase Agreement by and among Cytogen Corporation and the Purchasers (as defined therein) dated July 10, 2003. Filed as an exhibit to our Current Report Form 8-K, dated July 10, 2003, filed with the Securities and Exchange Commission on July 11, 2003, and incorporated herein by reference.

10.5 Form of Common Stock Purchase Warrant issued by Cytogen Corporation in favor of each Purchaser (as defined therein) dated July 10, 2003. Filed as an exhibit to our Current Report Form 8-K, dated July 10, 2003, filed with the Securities and Exchange Commission on July 11, 2003, and incorporated herein by reference.

10.6 Registration Rights Agreement by and among Cytogen Corporation and the Purchasers dated July 10, 2003. Filed as an exhibit to our Current Report Form 8-K, dated July 10, 2003, filed with the Securities and Exchange Commission on July 11, 2003, and incorporated herein by reference.

31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.

31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. Filed herewith.

32 Certification pursuant to 18 U.S.C. Section 1350. Filed herewith.

(b) Reports on Form 8-K

On April 9, 2003, we filed a Current Report on Form 8-K, dated April 8, 2003, under Item 5, with respect to the termination of our License and Distribution Agreement and Product Manufacturing and Supply Agreement with Draximage Inc., with respect to both of DRAXIS' BrachySeed(TM) I-125 and BrachySeed(TM) Pd-103 products.

On May 14, 2003, we furnished a Current Report on Form 8-K, dated May 14, 2003, under Item 9, containing a copy of our earnings release for the period ended March 31, 2003 (including financial statements) pursuant to Item 12 (Results of Operations and Financial Condition).

On June 9, 2003, we filed a Current Report on Form 8-K, dated June 6, 2003, under Item 5, announcing that we entered into a securities purchase agreement with certain institutional investors pursuant to which we issued and sold 1,052,632 shares of our common stock at $4.75 per share and issued warrants to such investors to purchase 315,790 shares of our common stock with an exercise price of $6.91 per share.

On July 3, 2003, we filed a Current Report on Form 8-K, dated

June 18, 2003, under Item 5, announcing that we issued a joint press release with Advanced Magnetics, Inc. regarding the publication of clinical data in the New England Journal of Medicine.

On July 11, 2003, we filed a Current Report on Form 8-K, dated July 10, 2003, under Item 5, announcing that we entered into a securities purchase agreement with certain institutional investors pursuant to which we issued and sold an aggregate of 1,172,332 shares of our common stock at $8.53 per share and also issued warrants to such investors to purchase an aggregate of 1,172,332 shares of our common stock with an exercise price of $12.80 per share.

On July 14, 2003, we filed a Current Report on Form 8-K, dated July 14, 2003, under Item 5, announcing that we reached certain agreements with Progenics Pharmaceuticals, Inc. regarding our joint venture with Progenics.

On July 15, 2003, we filed a Current Report on Form 8-K, dated July 15, 2003, under Item 5, announcing that we issued a joint press release regarding presentations made at the International Society for Magnetic Resonance in Medicine's 11th Scientific Meeting, of data showing that magnetic resonance with Combidex aids in the non-invasive diagnosis of metastatic lymph nodes.

On August 1, 2003, we filed a Current Report on Form 8-K, dated August 1, 2003, under Item 5, announcing that we reacquired the marketing rights held by Berlex Laboratories to Quadramet in North and Latin America, in exchange for an upfront payment of $8.0 million and royalties based on future sales.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CYTOGEN CORPORATION

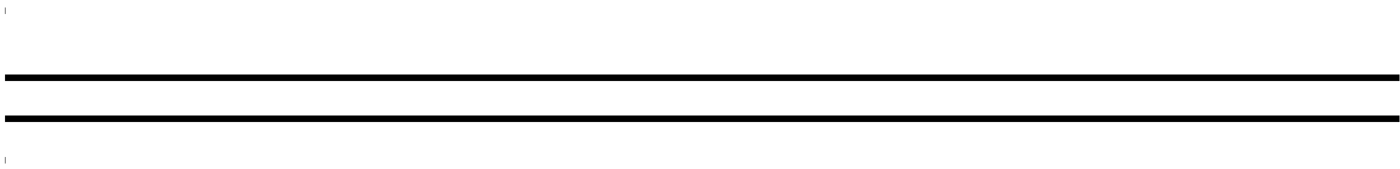
Date: August 14, 2003 By: /s/ Michael D. Becker

Michael D. Becker
President and Chief Executive Officer

Date: August 14 2003 By /s/ Thu A. Dang

Thu A. Dang

Vice President, Finance
(Principal Financial and Accounting Officer)



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

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KNIGHT CAPITAL GROUP, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the nine months ended September 30,	
	2005	**2004 Restated**
Cash flows from operating activities		
Net income (loss)	$ 24,489,688	$ (17,276,962)
Income from discontinued operations, net of tax	122,007	14,948,350
Income (loss) from continuing operations, net of tax	24,367,681	(32,225,312)
Adjustments to reconcile income (loss) from continuing operations, net of tax to net cash used in operating activities		
Depreciation and amortization	12,245,859	10,870,338
Income tax benefit on stock awards exercised	4,862,396	5,134,485
Stock-based compensation	9,965,376	9,144,843
Writedown of assets and lease loss accrual	10,055,252	3,498,261
Unrealized gain on strategic investments	708,178	
(Increase) decrease in operating assets		
Securities owned	(121,907,440)	(47,343,117)
Receivable from brokers and dealers	(9,450,118)	(59,193,729)
Other assets	10,186,580	(5,948,956)
Increase (decrease) in operating liabilities		
Securities sold, not yet purchased	122,199,036	55,603,309
Payable to brokers and dealers	5,889,153	67,548,200
Accrued compensation expense	(28,640,677)	(12,221,904)
Accrued expenses and other liabilities	(51,509,904)	75,597,998
Net cash (used in) provided by operating activities	(11,028,628)	70,464,416
Cash flows from investing activities		
Purchases of fixed assets and leasehold improvements	(23,150,560)	(28,595,353)
Investment in Deephaven sponsored funds	(66,518,200)	(8,726,915)
Purchase of Direct Trading Institutional business, net of cash acquired	(34,354,151)	
Proceeds from (purchases of) strategic investments	2,308,016	(5,738,199)
Net cash used in investing activities	(121,714,895)	(43,060,467)
Cash flows from financing activities		
Stock options exercised	16,903,069	13,103,668
Cost of common stock repurchased	(146,262,736)	(46,696,406)
Purchase of shares from minority investors in Knight Roundtable Europe Limited		(2,500,000)
Net cash used in financing activities	(129,359,667)	(36,092,738)
Decrease in cash and cash equivalents	(262,103,190)	(8,688,789)

Net cash provided by (used in) discontinued operations	122,007	(31,318,777)
Cash and cash equivalents at beginning of the year	445,539,282	249,997,693
Cash and cash equivalents at end of the year	$ 183,558,099	$ 209,990,127
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 112,234	$ 323,019
Cash paid for income taxes	$ 45,701,637	$ 26,653,232
Supplemental disclosure of noncash investing activities		
Goodwill	20,747,429	
Intangible assets	20,000,000	
Receivable from brokers and dealers	1,927,262	
Other net liabilities	(8,320,540)	
Cash paid for purchase of Direct Trading Institutional business, net of cash acquired	34,354,151	

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

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KNIGHT CAPITAL GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

SEPTEMBER 30, 2005

(Unaudited)

1. Organization and Description of the Business

Knight Capital Group, Inc. and its subsidiaries (the Company) have two operating business segments, Asset Management and Equity Markets, and a Corporate segment. The Company s operating business segments from continuing operations comprise the following operating subsidiaries:

Asset Management

Deephaven Capital Management LLC (Deephaven) is the investment manager and sponsor of the Deephaven investment funds (the Deephaven Funds). Deephaven also has a U.K. registered investment advisor subsidiary, which is regulated by the Financial Services Authority (FSA) in the U.K., and a Hong Kong registered investment advisor subsidiary, which is regulated by the Securities and Futures Commission in Hong Kong.

Equity Markets

Knight Equity Markets, L.P. (KEM) operates as a market maker in over-the-counter (OTC) equity securities, primarily those traded in the Nasdaq stock market and on the OTC Bulletin Board (OTCBB). Additionally, in December 2003, KEM acquired the business of Donaldson & Co., Incorporated (Donaldson), a firm that offers soft dollar and commission recapture services. KEM is a broker-dealer registered with the Securities and Exchange Commission (SEC) and is a member of the National Association of Securities Dealers (NASD), the National Stock Exchange and the Pacific Stock Exchange.

Knight Capital Markets LLC (KCM) operates as a market maker in the Nasdaq Intermarket , the over-the-counter market for New York Stock Exchange (NYSE) and American Stock Exchange (AMEX) listed securities. KCM is a broker-dealer registered with the SEC and is a member of the NASD.

Knight Equity Markets International Limited (KEMIL) is a U.K. registered broker-dealer that provides execution services for European institutional and broker-dealer clients in U.S. and European equities. KEMIL is regulated by the FSA and is a member of the London Stock Exchange and Euronext.

In June 2005, the Company acquired the business of Direct Trading Institutional, Inc., a privately held Texas-based firm specializing in providing institutions with direct access trading through an advanced electronic platform. This business is

now operated by Direct Trading Institutional, L.P. (DTI), a broker-dealer registered with the SEC and member of the NASD and National Futures Association.

In October 2005, the Company acquired the business of the ATTAIN ECN from Domestic Securities, Inc., a privately held company, and certain of its shareholders. The business, operating under the name Direct Edge ECN LLC (Direct Edge) operates as a liquidity destination offering the ability to match trades in Nasdaq National Market and Nasdaq SmallCap securities by displaying orders in the Nasdaq Market Center or the NASD Alternative Display Facility. Direct Edge is a broker-dealer registered with the SEC and is a member of the NASD.

The Corporate segment includes all corporate overhead expenses and investment income earned on strategic investments and the corporate investment in the Deephaven Funds. Corporate overhead expenses primarily consist of compensation for certain senior executives and other individuals employed at the corporate holding company, legal and other professional expenses related to corporate matters, investor and public relations expenses and directors and officers insurance.

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Discontinued Operations

The Company completed the sale of its Derivative Markets business to Citigroup Financial Products, Inc. (Citigroup) for $237 million in cash as of the close of business on December 9, 2004. In accordance with generally accepted accounting principles (GAAP), the results of the Derivative Markets segment have been included within discontinued operations for all periods presented. For a further discussion of the sale of the Company s Derivative Markets business and its associated accounting treatment, see Footnote 9 Discontinued Operations.

2. Significant Accounting Policies

Basis of consolidation and form of presentation

The accompanying unaudited consolidated financial statements include the accounts of the Company and its subsidiaries and, in the opinion of management, reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim period. All significant intercompany transactions and balances within continuing operations have been eliminated. Certain footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. The nature of the Company s business is such that the results of an interim period are not necessarily indicative of the results for the full year. These unaudited consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s amended Annual Report on Form 10-K/A for the year ended December 31, 2004 as filed with the SEC.

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

Cash and cash equivalents

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

Market making and sales activities

Securities owned and securities sold, not yet purchased, which primarily consist of listed and OTC equities, are carried at market value and are recorded on a trade date basis. Net trading revenue (trading gains, net of trading losses) and commissions (which includes commission equivalents earned on institutional client orders) and related expenses are also recorded on a trade date basis.

Payments for order flow represent payments to broker-dealer clients for directing their order executions to the Company. Soft dollar and commission recapture expense represents payments to institutions in connection with soft dollar and commission recapture programs. The Company s clearing agreements call for payment or receipt of interest income, net of interest expense, for facilitating the settlement and

financing of securities transactions.

Asset management fees

The Company earns asset management fees for sponsoring and managing the Deephaven Funds. Such fees are recorded monthly as earned and are calculated as a percentage of the Deephaven Funds monthly net assets, plus a percentage of a new high net asset value (the Incentive Allocation Fee), as defined, for any six month period ended June 30th or December 31st. A new high net asset value is generally defined as the amount by which the net asset value of the Deephaven Funds exceeds the greater of either the highest previous net asset

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value in the Deephaven Funds, or the net asset value at the time each investor made a purchase. The Incentive Allocation Fee may increase or decrease during the year based on the performance of the Deephaven Funds. If Deephaven s Market Neutral Fund, which contains the majority of assets under management, recognizes a loss in the second half of a calendar year, the Incentive Allocation Fee is recalculated on an annual rather than a semi-annual basis. As such, the Incentive Allocation Fee may be negative for certain periods, but not lower than zero on a year-to-date basis.

Estimated fair value of financial instruments

The Company s securities owned and securities sold, not yet purchased are carried at market value, which is estimated using market quotations available from major securities exchanges, clearing brokers and dealers. Management estimates that the fair values of other financial instruments recognized on the Consolidated Statements of Financial Condition (including receivables, payables and accrued expenses) approximate their carrying values, as such financial instruments are short-term in nature, bear interest at current market rates or are subject to frequent repricing.

Goodwill and intangible assets

The Company applies the provisions of Statement of Financial Accounting Standards (SFAS) No. 142 *Goodwill and Other Intangible Assets,* which requires that goodwill and intangible assets with an indefinite useful life no longer be amortized, but instead, be tested for impairment annually or when an event occurs or circumstances change that signify the existence of impairment. Other intangible assets are amortized over their useful lives.

Strategic investments

Strategic investments include equity ownership interests of less than 20% in financial services-related businesses and are accounted for under the equity method or at fair value. The equity method of accounting is used for investments in limited partnerships and limited liability corporations. The fair value of investments, recorded in the Company s broker-dealer subsidiaries, for which a quoted market or dealer price is not available for the size of our investment, is based on management s estimate. Among the factors considered by management in determining the fair value of investments are the cost of the investment, terms and liquidity, developments since the acquisition of the investment, the sales price of recently issued securities, the financial condition and operating results of the issuer, earnings trends and consistency of operating cash flows, the long-term business potential of the issuer, the quoted market price of securities with similar quality and yield that are publicly traded, and other factors generally pertinent to the valuation of investments. The fair value of these investments is subject to a high degree of volatility and may be susceptible to significant fluctuations in the near term. Strategic investments are reviewed on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If the Company assesses that an impairment loss on the strategic investments has occurred due to declines in fair value or other market conditions, the investments are written down to its impairment value.

Investments that are classified as available-for-sale are reported at fair value with unrealized gains and losses excluded from earnings and reported, net of applicable taxes, in Accumulated other comprehensive income, net of tax within Stockholders equity on the Consolidated Statements of Financial Condition.

Investments not recorded in the Company s broker-dealer subsidiaries which do not have a readily determinable fair value, are recorded at amortized cost.

Treasury stock

The Company records its purchases of treasury stock at cost as a separate component of Stockholders equity. The Company obtains treasury stock through purchases in the open market or through privately negotiated transactions.

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Foreign currencies

The functional currency of the Company s consolidated foreign subsidiaries is the U.S. dollar. Assets and liabilities in foreign currencies are translated into U.S. dollars using current exchange rates at the date of the Consolidated Statements of Financial Condition. Revenues and expenses are translated at average rates during the periods.

Depreciation, amortization and occupancy

Fixed assets are being depreciated on a straight-line basis over their estimated useful lives of three to seven years. Leasehold improvements are being amortized on a straight-line basis over the shorter of the life of the related office lease or the expected useful life of the assets. The Company records rent expense on a straight-line basis over the lives of the leases. The Company capitalizes certain costs associated with the acquisition or development of internal-use software and amortizes the software over its estimated useful life of three years, commencing at the time the software is placed in service.

Writedown of fixed assets

Writedowns of fixed assets are recognized when it is determined that the fixed assets are impaired. The amount of the impairment writedown is determined by the difference between the carrying amount and the fair value of the fixed asset. In determining the impairment, an estimated fair value is obtained through research and inquiry of the market. Fixed assets are reviewed for impairment on a quarterly basis.

Lease loss accrual

It is the Company s policy to identify excess real estate capacity and where applicable, accrue for such future costs. In determining the accrual, a nominal cash flow analysis is performed for lease losses initiated prior to December 31, 2002, the effective date of SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities,* and costs related to the excess capacity are accrued. For lease losses initiated after December 31, 2002, the Company s policy is to accrue future costs related to excess capacity using a discounted cash flow analysis.

Income taxes

The Company records deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. The Company evaluates the recoverability of future tax deductions by assessing the adequacy of future expected taxable income from all sources, including reversal of temporary differences and forecasted operating earnings. Net deferred tax assets and liabilities are included in Other assets and Accrued expenses and other liabilities, respectively, on the Consolidated Statements of Financial Condition.

Discontinued Operations

In accordance with SFAS No. 144, *Accounting for the Disposal of Long-Lived Assets*, the revenues and expenses associated with a separate segment or reporting unit that has been disposed of through closure or sale are included within Income from discontinued operations, net of tax, on the Consolidated Statements of Operations for all periods presented.

Stock-based compensation

The Company applies Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees* (APB 25) and related interpretations in accounting for its stock options plans. As options are granted at the then market value, no compensation expense has been recognized for the fair values of the options granted to employees.

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Had compensation expense for the Company s options been determined based on the fair value at the grant dates in accordance with SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company s net income (loss) and earnings per share amounts for the three and nine months ended September 30, 2005 and 2004 would have been as follows (in millions, except per share data):

	Three months ended September 30,		Nine months ended September 30,	
	2005	**2004**	**2005**	**2004**
Net income (loss), as reported	$ 24.4	$ (1.3)	$ 24.5	$ (17.3)
Pro forma compensation expense determined under fair value based method, net of tax	(1.1)	(1.2)	(4.1)	(5.2)
Pro forma net income (loss)	23.3	(2.4)	20.3	(22.5)
Basic earnings per share, as reported	0.24	(0.01)	0.23	(0.15)
Diluted earnings per share, as reported	0.23	(0.01)	0.23	(0.15)
Pro forma basic earnings per share	0.23	(0.02)	0.19	(0.20)
Pro forma diluted earnings per share	0.22	(0.02)	0.19	(0.20)

The Company records the fair market value of restricted stock awards on the date of grant as unamortized stock-based compensation in Stockholders equity and amortizes the balance to compensation expense ratably over the vesting period.

Other

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

Restatement of financial statements

On August 9, 2005, the Company filed (i) an amended 2004 Annual Report on Form 10-K/A to reflect a correction in accounting for certain property lease transactions (the Lease Correction) and (ii) an amended Form 10-Q/A for the three months ended March 31, 2005 to reflect the Lease Correction and an adjustment to the Company s Receivables from and Payables to brokers and dealers. The following table isolates each of the restated amounts in the Company s Consolidated Statements of Operations for the three and nine months ended September 30, 2004.

	For the three months ended September 30, 2004	For the nine months ended September 30, 2004
	As restated	**As restated**

		As originally reported		As originally reported
Consolidated Statements of Operations				
Expenses				
Depreciation and amortization	$ 3,390,310	$ 3,338,134	$ 10,870,338	$ 10,720,438
Occupancy and equipment rentals	4,144,040	3,981,784	12,880,850	12,817,436
Loss from continuing operations before income taxes	(10,972,972)	(10,750,940)	(38,162,273)	(37,938,113)
Income tax (benefit)	(4,367,404)	(4,280,801)	(5,936,961)	(5,831,980)
Net loss from continuing operations	(6,605,568)	(6,470,139)	(32,225,312)	(32,106,133)
Net loss	(1,261,607)	(1,126,178)	(17,276,962)	(17,157,783)

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3. Securities Owned and Securities Sold, Not Yet Purchased

Securities owned and securities sold, not yet purchased are carried at market value and consist of the following (in millions):

	September 30, 2005	December 31, 2004
Securities owned:		
Equities	$ 367.8	$ 245.5
U.S. government obligations	8.6	9.0
	$ 376.4	$ 254.5
Securities sold, not yet purchased:		
Equities	$ 343.6	$ 221.4
	$ 343.6	$ 221.4

4. Receivable from and Payable to Brokers and Dealers

Amounts receivable from and payable to brokers and dealers consist of the following (in millions):

	September 30, 2005	December 31, 2004
Receivable:		
Clearing brokers and other	$ 143.9	$ 145.4
Securities failed to deliver	65.6	64.5
Securities borrowed	46.8	35.0
	$ 256.3	$ 244.9
Payable:		
Clearing brokers and other	$ 58.5	$ 47.8
Securities failed to receive	35.9	40.7
	$ 94.4	$ 88.5

5. Goodwill and Intangible Assets

In June 2005, the Company tested for the impairment of goodwill and intangible assets and concluded that there was no impairment. The goodwill balance of $39.9 million at September 30, 2005 relates to the Equity Markets segment. Goodwill is net of accumulated amortization of

$21.9 million recorded through December 31, 2001, the effective date the Company adopted SFAS No. 142. Goodwill increased by $20.7 million in June 2005, resulting from the purchase of DTI s business. In the first half of 2004, the Company acquired all of the ownership interests of the minority owners of Knight Roundtable Europe Limited (KREL) (which is the Company s subsidiary that owns KEMIL) for $2.5 million, which was recorded as goodwill.

At September 30, 2005, the Company had intangible assets, net of accumulated amortization, of $30.5 million, all included within the Equity Markets segment. Intangible assets increased by $20.0 million in June 2005, resulting from the purchase of DTI s business. Intangible assets are being amortized over the remaining useful lives, which have been determined to range from two to thirty years and primarily represent client relationships.

In the third quarter of 2005, the Company recorded amortization expense related to its intangible assets within its Equity Markets segment of $735,000. The estimated amortization expense relating to the intangible assets for each of the next five years approximates $735,000 for the remainder of 2005, $2.9 million per year in 2006 and 2007, and $2.8 million per year from 2008 through 2009.

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The chart below summarizes the activity of the Company s Goodwill and Intangible assets, net of accumulated amortization, for the nine months ended September 30, 2004 and 2005, respectively (in millions).

	Equity Markets	
	Goodwill	Intangible Assets
Balance at January 1, 2004	$ 16.7	$ 12.0
Purchase of shares from minority investors in KREL and other intangibles	2.5	0.2
Amortization expense		(0.5)
Balance at September 30, 2004	$ 19.2	$ 11.7
Balance at January 1, 2005	$ 19.2	$ 11.5
Purchase of DTI business	20.7	20.0
Amortization expense		(1.0)
Balance at September 30, 2005	$ 39.9	$ 30.5

6. Investment in Deephaven Sponsored Funds and Strategic Investments

The Company s wholly-owned subsidiary, Deephaven, is the investment manager and sponsor of the Deephaven Funds, which engages in various trading strategies involving equities, debt instruments and derivatives. The underlying investments in the Deephaven Funds are carried at market value. Of the $3.4 billion of assets under management in the Deephaven Funds as of September 30, 2005, the Company had a corporate investment of $281.8 million. Additionally, Other assets on the Consolidated Statements of Financial Condition at September 30, 2005 and December 31, 2004 included $22.6 million and $19.9 million, respectively, of investments in the Deephaven Funds related to employee deferred compensation plans. In addition, certain officers, directors and employees of the Company had direct investments of approximately $4.2 million in the Deephaven Funds, in the aggregate, as of September 30, 2005.

In connection with the sale of the Derivative Markets business (see Footnote 9, Discontinued Operations) and in light of the reorganization of the Company s business segments, the Company transferred its investments in the International Securities Exchange (ISE) and The Nasdaq Stock Market (Nasdaq), which were previously held by its broker-dealer subsidiaries, to a corporate investment holding company. During the first quarter of 2005, these equity investments became marketable and, accordingly, were accounted for as equity securities under SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities* and were classified as available-for-sale securities. On March 9, 2005, in conjunction with the ISE s initial public offering, the Company sold approximately 30% of its original equity ownership of the ISE, having an original cost of $3.0 million, for $12.6 million resulting in a pre-tax gain of $9.6 million. There were no sales of the ISE equity during the third quarter of 2005. As of September 30, 2005, the Company owned 1.7 million shares of common stock of the ISE, which had an aggregate fair value and amortized cost of $40.6 million and $6.9 million, respectively.

During the second quarter of 2005, the Company sold its Nasdaq equity investment, previously classified as available-for-sale, for $15.5 million. Based on an original cost of $7.4 million, the Company recognized a pre-tax gain of $8.1 million on the sale of this equity investment.

7. Significant Clients

The Company considers significant clients to be clients who account for 10% or more of the total U.S. equity dollar value traded by the Company during the period. One client accounted for approximately 12.0% and 10.6% of the Company s U.S. equity dollar value traded during the three and nine months ended September 30, 2005, respectively. Payments for order flow to this firm for U.S. equity order flow for the three and nine months ended September 30, 2005 amounted to $1.3 million and $2.4 million, respectively.

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The Company s corporate investment in the Deephaven Funds of $281.8 million accounted for 8.3% of total assets under management at September 30, 2005. One institutional investor accounted for more than 10% of the Deephaven Funds assets under management, with 10.6% at September 30, 2005.

8. Writedown of Assets and Lease Loss Accrual

The Writedown of assets and lease loss accrual for the three months ended September 30, 2005 of $5.5 million related to the cost associated with excess real estate capacity at our 545 Washington Boulevard facility in Jersey City, N.J. The Writedown of assets and lease loss accrual for the nine months ended September 30, 2005 was $10.1 million, which includes $4.5 million of costs associated with excess real estate capacity and a writedown of fixed assets related to the move from the Company s 525 Washington Boulevard facility in Jersey City, N.J. during the second quarter of 2005 and an additional $5.5 million in costs associated with excess real estate capacity at our 545 Washington Boulevard facility in Jersey City, N.J.

The Writedown of assets and lease loss accrual for the three months ended September 30, 2004 was $874,000, relating to the writedown of fixed assets that are no longer actively used. The Writedown of assets and lease loss accrual for the nine months ended September 30, 2004 was $3.5 million, which includes $2.6 million of costs associated with excess real estate capacity at our 545 Washington Boulevard facility in Jersey City, N.J.

9. Discontinued Operations

Derivative Markets

The Company completed the sale of its Derivative Markets business to Citigroup for $237 million in cash as of the close of business on December 9, 2004. The final purchase price was subject to adjustment based on the final determination of the book value of the Derivative Markets segment at the time the deal closed. The final determination of book value occurred in the first quarter of 2005, at which time the adjustment was recognized. The result of this adjustment and other expenses related to the sale resulted in a loss from discontinued operations, net of tax, of $266,000 in the first quarter of 2005. During the third quarter of 2005, the Company recorded additional income of $388,000, net of tax, relating to the Derivative Markets segment.

The decision to sell the Derivative Markets segment was based on a review of the overall options industry, the capital and risk required to maintain this business successfully and the business role in the Company s long-term strategy. In accordance with SFAS No. 144, *Accounting for the Disposal of Long-Lived Assets*, the results of the Derivative Markets segment, the revenues and expenses associated with these businesses as well as all costs associated with the sale transaction have been included in Income from discontinued operations, net of tax on the Consolidated Statements of Operations for all periods presented.

The revenues and results of operations of the discontinued operations for the three and nine months ended September 30, 2005 and 2004 are summarized as follows (in millions):

	For the	**For the**

	three months ended		nine months ended	
	September 30, 2005	September 30, 2004	September 30, 2005	September 30, 2004
Revenues	$	$ 47.2	$	$ 137.0
Pre-tax income from discontinued operations	0.7	8.9	0.2	25.1
Income tax expense	0.3	3.6	0.1	10.2
Income from discontinued operations, net of tax	$ 0.4	$ 5.3	$ 0.1	$ 14.9

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10. Commitments and Contingent Liabilities

In the ordinary course of business, the nature of the Company s business subjects it to claims, lawsuits, regulatory examinations and other proceedings. The results of these matters cannot be predicted with certainty. There can be no assurance that these matters will not have a material adverse effect on the Company s results of operations in any future period and a material judgment could have a material adverse impact on the Company s financial condition and results of operations. However, it is the opinion of management, after consultation with legal counsel that, based on information currently available, the ultimate outcome of these matters will not have a material adverse impact on the business, financial condition or operating results of the Company although they might be material to the operating results for any particular period, depending, in part, upon operating results for that period.

The Company leases office space under noncancelable operating leases. Certain office leases contain fixed escalation clauses. Rental expense from continuing operations under the office leases was $2.0 million and $2.8 million for the three months ended September 30, 2005 and September 30, 2004, respectively. For the nine months ended September 30, 2005 and September 30, 2004, rental expense from continuing operations was $6.9 million and $7.7 million, respectively.

The Company leases certain computer and other equipment under noncancelable operating leases. In addition, the Company has entered into guaranteed employment contracts with certain of its employees. As of September 30, 2005, future minimum rental commitments under all noncancelable office, computer and equipment leases (Operating Leases), and guaranteed employment contracts longer than one year (Other Obligations) were as follows (in millions):

	Operating Leases	Other Obligations	Total
Three months ending December 31, 2005	$ 3.8	$	$ 3.8
Year ending December 31, 2006	10.4	24.6	35.0
Year ending December 31, 2007	9.9	2.0	11.9
Year ending December 31, 2008	9.7	0.6	10.3
Year ending December 31, 2009	9.3		9.3
Thereafter through October 31, 2021	111.6		111.6
	$ 154.8	$ 27.3	$ 182.1

During the normal course of business, the Company collateralizes certain leases, employment agreements or other contractual obligations through letters of credit or segregated funds held in escrow accounts. As of September 30, 2005, the Company has provided an $8.0 million letter of credit, collateralized by U.S. Treasury Bills, as a guarantee for one of the Company s lease obligations.

The Company entered into long-term employment contracts with the senior management team of Deephaven (the Deephaven managers). These employment agreements, which became effective on January 1, 2004, are for three-year terms and include an option for renewal by the Deephaven managers through 2009 under certain circumstances. Pursuant to the terms of a simultaneously executed option agreement between the Company and the Deephaven managers, in the event of a change of control of the Company during the initial three-year employment term, the Deephaven managers would have the option (the Option) to obtain a 51% interest in Deephaven in exchange for the termination of their employment contracts and associated profit-sharing bonuses and other employee profit-sharing plans, which in the aggregate range from 42% to 50% of the pre-tax, pre-profit sharing profits of Deephaven during the term of the agreements, subject to meeting certain annual guaranteed amounts. If a change of control of the Company were to occur, and if the Deephaven managers exercised the Option, the Company would retain a 49% interest in Deephaven. In addition, during the life of the Option, the agreements provide that the Company may not sell Deephaven

without the approval of the Deephaven managers.

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In May 2005, the Company announced that it had reached an agreement to acquire, for cash, the business of the ATTAIN ECN, an alternative trading system that operates an electronic communications network (ECN) for the trading of Nasdaq securities. In October 2005, the Company closed the transaction. The business operates under the name of Direct Edge ECN LLC.

11. Regulatory Charges and Related Matters

In June 2005, Deephaven and a former Deephaven employee received Wells Notices from the staff of the SEC s Division of Enforcement. The Wells Notice to Deephaven indicates that the staff is considering recommending that the Commission bring a civil injunctive action against Deephaven alleging that it violated anti-fraud provisions of the securities laws in connection with trading activity associated with certain Private Investments in Public Equities (PIPEs) during the period from June 1, 1999 through March 2004. The Wells Notice also indicates that the staff may seek an injunction, civil penalties, and disgorgement (including prejudgment interest). A Wells Notice from the SEC affords recipients an opportunity to present information and defenses in response to the SEC s Division of Enforcement staff prior to the staff making its formal recommendation to the Commission on whether any action should be authorized. Deephaven has submitted its initial response to the Wells Notice. During the second quarter of 2005, the Company recorded a $2.0 million, pre-tax, charge relating to the PIPEs matter, included in Regulatory charges and related matters on the Consolidated Statements of Operations.

In March 2004, Knight Securities L.P. (KSLP, now known as KEM) received Wells Notices from the staffs of the SEC s Division of Enforcement and from NASD s Department of Market Regulation. On July 7, 2004, the Company announced that KSLP had reached an agreement in principle with the staffs of the SEC and NASD to settle the investigations covered by these Wells Notices, which remained subject to the drafting of settlement papers and final approval by the SEC and NASD. On December 16, 2004, the Company announced that KSLP concluded its settlement with the SEC and NASD (collectively the Settlement).

The terms of the Settlement provided that KSLP disgorge $41.1 million in institutional trading profits, and pay approximately $13.2 million in interest and $25.0 million in penalties, for a total of $79.3 million, which is recorded as Regulatory charges and related matters on the Consolidated Statements of Operations. The Company did not record a tax benefit for the $25.0 million penalty. The amount was paid in full in the fourth quarter of 2004.

12. Comprehensive Income

Comprehensive income includes net income (loss) and changes in equity except those resulting from investments by, or distributions to, stockholders. Comprehensive income is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2005	**2004**	**2005**	**2004**
Net income (loss)	$ 24.4	$ (1.3)	$ 24.5	$ (17.3)
Other comprehensive income, net of tax:				
Net unrealized (losses) gains on investment securities held as available-for-sale	(1.8)		19.9	
Total comprehensive income (loss), net of tax	$ 22.6	$ (1.3)	$ 44.4	$ (17.3)

Other comprehensive income, net of tax, represents net unrealized (losses) gains on the Company s strategic investment in the ISE.

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13. Earnings per Share

Basic earnings per common share (EPS) has been calculated by dividing net income by the weighted average shares of Class A Common Stock outstanding during each respective period. Diluted EPS reflects the potential reduction in EPS using the treasury stock method to reflect the impact of common stock equivalents if stock awards such as stock options and restricted stock were exercised or converted into Class A Common Stock.

The following is a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the three and nine months ended September 30, 2005 and 2004 (in millions, except for share and per share data):

	For the three months ended September 30,			
	2005		2004	
	Numerator / net income	Denominator / shares	Numerator / net loss	Denominator / shares
Net income (loss) and shares used in basic calculations	$ 24.4	101,264,048	$ (1.3)	112,012,941
Effect of dilutive stock-based awards		2,460,154		
Net income (loss) and shares used in diluted calculations	$ 24.4	103,724,202	$ (1.3)	112,012,941
Basic earnings per share		$ 0.24		$ (0.01)
Diluted earnings per share		$ 0.23		$ (0.01)

	For the nine months ended September 30,			
	2005		2004	
	Numerator / net income	Denominator / shares	Numerator / net loss	Denominator / shares
Net income (loss) and shares used in basic calculations	$ 24.5	104,791,642	$ (17.3)	112,816,260
Effect of dilutive stock-based awards		3,164,280		
Net income (loss) and shares used in diluted calculations	$ 24.5	107,955,922	$ (17.3)	112,816,260
Basic earnings per share		$ 0.23		$ (0.15)
Diluted earnings per share		$ 0.23		$ (0.15)

For the three and nine months ended September 30, 2004, 3.9 million and 5.6 million shares of common stock equivalents, respectively, were not included in the calculation of weighted average shares for diluted earnings per share. The Company incurred losses during these periods and the effect of their inclusion would be anti-dilutive.

14. Stock-Based Compensation

The Company has established the Knight Capital Group, Inc. 1998 Long Term Incentive Plan, the Knight Capital Group, Inc. 1998 Nonemployee Director Stock Option Plan and the Knight Capital Group, Inc. 2003 Equity Incentive Plan (collectively, the Plans). The purpose of the Plans is to provide long-term incentive compensation to employees and directors of the Company. The Plans are administered by the Compensation Committee of the Company s Board of Directors, and allow for the grant of options, restricted stock and restricted stock units (collectively, the awards), as defined by the Plans. In addition, the Plans limit the number of awards that may be granted to a single individual and the Plans also limit the number of shares of restricted stock or restricted stock units that may be awarded.

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The Company s policy is to grant options for the purchase of shares of Class A Common Stock at not less than market value, which the Plans define as the average of the high and low sales prices on the date prior to the grant date. Options generally vest over a three or four-year period and expire on the fifth or tenth anniversary of the grant date, pursuant to the terms of the agreements. Restricted stock awards generally vest over three years. The Company has the right to fully vest employees in their awards upon retirement and in certain other circumstances.

The Company did not grant any restricted shares under the Plans during the third quarter of 2005 as stock-based compensation. At September 30, 2005, the Company had 3.1 million restricted shares outstanding, in aggregate, both under and outside of the Plans. The Company recognizes compensation expense for the fair values of the restricted shares of Class A Common Stock granted to employees over the vesting period. For the three months ended September 30, 2005 and 2004, the Company recorded compensation expense relating to restricted shares of $3.2 million and $2.4 million, respectively, and $10.0 million and $6.8 million for the nine months ended September 30, 2005 and 2004, respectively, all of which has been included in Employee compensation and benefits on the Consolidated Statements of Operations.

15. Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return as well as combined state income tax returns in certain jurisdictions. In other jurisdictions, the Company and its subsidiaries file separate company state income tax returns.

The following table reconciles the U.S. federal statutory income tax (benefit) rate to the Company s actual income tax (benefit) rate:

	For the three months ended September 30,		For the nine months ended September 30,	
	2005	**2004**	**2005**	**2004**
U.S. federal statutory income tax (benefit) rate	35.0%	(35.0%)	35.0%	(35.0%)
U.S. state and local income tax (benefit) rate, net of U.S. federal income tax effect	4.6%	(3.4%)	4.8%	(1.9%)
Nondeductible charges	0.2%	3.5%	1.3%	24.4%
Other, net	0.4%	(4.9%)	0.0%	(3.1%)
Effective income tax (benefit) rate	40.2%	(39.8%)	41.1%	(15.6%)

16. Business Segments

The Company currently has two operating business segments within continuing operations, Equity Markets and Asset Management, and a Corporate segment. The Equity Markets segment primarily represents the businesses that provide comprehensive trade execution services in U.S. equities. The Asset Management segment consists of investment management and sponsorship of the Deephaven Funds. The Corporate segment includes all corporate overhead expenses and investment income earned on strategic investments and the Company s corporate investment in the Deephaven Funds. Corporate overhead expenses primarily consist of compensation for certain senior executives and other individuals employed at the corporate holding company, legal and other professional expenses relating to corporate matters, investor and public

relations expenses and directors and officers insurance.

In 2004, the Company sold one of its business segments, Derivative Markets. The revenues and expenses associated with Derivative Markets have been included within Income from discontinued operations, net of tax on the Consolidated Statements of Operations for all periods presented. For a discussion of discontinued operations, see Footnote 9, Discontinued Operations.

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The Company s revenues, income (loss) from continuing operations before income taxes and total assets by segment are summarized below (amounts in millions):

	Equity Markets	Asset Management	Corporate	Consolidated Total
For the three months ended September 30, 2005:				
Revenues	$ 129.4	$ 42.3	$ 12.4	$ 184.1
Income from continuing operations before income taxes	19.1	15.7	5.3	40.1
Total assets	1,001.1	64.0	324.3	1,389.4
For the three months ended September 30, 2004:				
Revenues	$ 95.4	$ 6.8	$ (0.4)	$ 101.8
(Loss) from continuing operations before income taxes	(3.3)	(0.5)	(7.2)	(11.0)
Total assets[1]	858.7	27.1	242.3	1,128.2

	Equity Markets	Asset Management	Corporate	Consolidated Total
For the nine months ended September 30, 2005:				
Revenues	$ 335.9	$ 68.3	$ 29.2	$ 433.3
Income from continuing operations before income taxes	12.1	17.9	11.4	41.4
Total assets	1,001.1	64.0	324.3	1,389.4
For the nine months ended September 30, 2004:				
Revenues	$ 404.4	$ 28.9	$ 6.8	$ 440.2
(Loss) income from continuing operations before income taxes	(28.3)	7.3	(17.2)	(38.2)
Total assets[1]	858.7	27.1	242.3	1,128.2

[1] Total assets at September 30, 2004 do not include Assets within discontinued operations of $3.1 billion.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

On August 9, 2005, the Company filed (i) an amended 2004 Annual Report on Form 10-K/A to reflect a correction in accounting for certain property lease transactions (the Lease Correction) and (ii) an amended Form 10-Q/A for the three months ended March 31, 2005 to reflect the Lease Correction and an adjustment to the Company s Receivables from and Payables to brokers and dealers. As applicable, this Item 2 has been revised to reflect these changes.

The following discussion of our results of operations should be read in conjunction with our consolidated financial statements and notes thereto included in our amended Annual Report on Form 10-K/A for the year ended December 31, 2004 as filed with the Securities and Exchange Commission (SEC). This discussion contains forward-looking statements that involve risks and uncertainties, including those discussed in our Form 10-K/A. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including, but not limited to, those set forth elsewhere in this document and in our Form 10-K/A.

Certain statements contained in this Quarterly Report on Form 10-Q, including without limitation, those under Management s Discussion and Analysis of Financial Condition and Results of Operations herein (MD&A), Quantitative and Qualitative Disclosures About Market Risk in Part I, Item 3, and Legal Proceedings in Part II, Item 1, and the documents incorporated by reference, may constitute forward-looking statements. These forward-looking statements are not historical facts, and are based on current expectations, estimates and projections about the Company s industry, management s beliefs and certain assumptions made by management, many of which, by their nature, are inherently uncertain and beyond our control. Accordingly, readers are cautioned that any such forward-looking statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to predict including, without limitation, risks associated with the costs and integration, performance and operation of the businesses being acquired by the Company. Since such statements involve risks and uncertainties, the actual results and performance of the Company may turn out to be materially different from the results expressed or implied by such forward-looking statements. Given these uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements. Unless otherwise required by law, the Company also disclaims any obligation to update its view of any such risks or uncertainties or to announce publicly the result of any revisions to the forward looking statements made in this report. Readers should carefully review the risks and uncertainties under Certain Factors Affecting Results of Operations within MD&A herein, Risks Affecting our Business in the Company s Annual Report on Form 10-K/A, and those described in other reports or documents the Company files from time to time with the SEC. This discussion should be read in conjunction with the Company s consolidated financial statements and the notes thereto contained in this report.

Executive Overview

The Company currently has two operating segments, Asset Management and Equity Markets, and a Corporate segment.

Asset Management We operate an asset management business for institutions and high-net-worth individuals. Assets under management were $3.4 billion as of September 30, 2005, down slightly from $3.5 billion of assets under management as of September 30, 2004.

Equity Markets We are a leading execution specialist providing comprehensive trade execution services to institutional and broker-dealer clients, offering capital commitment and access to a deep pool of liquidity across the depth and breadth of the U.S. equity markets.

The Company s Corporate segment includes all corporate overhead expenses and investment income earned on strategic investments and our corporate investment in funds managed by the Asset Management segment (the Deephaven Funds). Corporate overhead expenses primarily

consist of compensation for certain senior

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executives and other individuals employed at the corporate holding company, legal and other professional expenses related to corporate matters, investor and public relations expenses and directors and officers insurance.

In the fourth quarter of 2004, the Company completed the sale of one of its segments, Derivative Markets, to Citigroup Financial Products, Inc. (Citigroup). In accordance with generally accepted accounting principles (GAAP), the results of this segment have been included within discontinued operations for all periods presented. The final purchase price was subject to adjustment based on the final determination of the book value of the Derivative Markets business at the time the deal closed. The results of this adjustment and other expenses related to the sale is included in Income from discontinued operations, net of tax on the Consolidated Statements of Operations included in Part I, Item 1 Financial Statements of this document. For a more detailed discussion of the sale of the Company s Derivative Markets business, please see Footnote 9 Discontinued Operations also included in Part I, Item 1 Financial Statements of this document.

The following table sets forth the revenues and expenses excluding Regulatory charges and related matters and Writedown of assets and lease loss accrual (Operating Expenses) and income (loss) from continuing operations before Regulatory charges and related matters and Writedown of assets and lease loss accrual and income taxes (Pre-Tax Operating Earnings) of our segments and on a consolidated basis (in millions):

	For the three months ended September 30,		For the nine months ended September 30,	
	2005	**2004**	**2005**	**2004**
Equity Markets				
Revenues	$ 129.4	$ 95.4	$ 335.9	$ 404.4
Operating Expenses	104.8	97.8	313.8	350.0
Pre-Tax Operating Earnings	24.6	(2.4)	22.1	54.4
Asset Management				
Revenues	42.3	6.8	68.3	28.9
Operating Expenses	26.5	7.3	48.3	21.6
Pre-Tax Operating Earnings	15.7	(0.5)	20.0	7.3
Corporate				
Revenues	12.4	(0.4)	29.2	6.8
Operating Expenses	7.1	6.8	17.8	24.0
Pre-Tax Operating Earnings	5.3	(7.2)	11.3	(17.2)
Consolidated				
Revenues	184.1	101.8	433.3	440.2
Operating Expenses	138.5	111.9	379.9	395.6
Pre-Tax Operating Earnings	$ 45.6	$ (10.1)	$ 53.4	$ 44.5

Total revenues from continuing operations for the three months ended September 30, 2005 increased 80.8% from the comparable period in 2004, while Operating Expenses from continuing operations increased 23.7%. Pre-Tax Operating Earnings increased to earnings of $45.6 million for the three months ended September 30, 2005, from a loss of $10.1 million in the comparable period in 2004. Our Asset Management segment was positively impacted by higher returns on the Deephaven Funds. Our Equity Markets segment benefited from higher equity dollar volume as well as the acquisition of the business of Direct Trading Institutional, Inc. (now operated as Direct Trading Institutional, L.P. (DTI)), a privately held firm specializing in providing institutions with direct access trading. The results from our Corporate segment were positively impacted by the higher returns on our corporate investment in the Deephaven Funds.

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Total revenues from continuing operations for the nine months ended September 30, 2005 decreased 1.6% from the comparable period in 2004, while Operating Expenses from continuing operations decreased 4.0%. Pre-Tax Operating Earnings increased to $53.4 million for the nine months ended September 30, 2005, from $44.5 million in the comparable period in 2004. Our Asset Management segment was positively impacted by higher fund returns and a higher average amount of assets under management. Our Equity Markets segment was affected by greater competition for broker-dealer client order flow and reduced revenue capture statistics. The results from our Corporate segment were positively impacted by the gain on the sale of our equity investment in Nasdaq and a portion of our equity investment in the International Securities Exchange, Inc. (ISE) as well as by higher returns on our corporate investment in the Deephaven Funds.

A reconciliation of GAAP income (loss) from continuing operations before income taxes (Pre-Tax GAAP Income) to Pre-Tax Operating Earnings and of total GAAP expenses to Operating Expenses is included elsewhere in this section.

Certain Factors Affecting Results of Operations

We have experienced, and expect to continue to experience, significant fluctuations in operating results due to a variety of factors, including, but not limited to, introductions or enhancements to market-making services by us or our competitors; the value of our securities positions and our ability to manage the risks attendant thereto; the equity market volumes; the dollar value of securities traded; volatility in the securities markets; our market share with institutional and broker-dealer clients; the performance of our international operations; our ability to manage personnel, overhead and other expenses, including our occupancy expenses under our office leases and legal fees related to our legal proceedings and other matters; the strength of our client relationships; the amount of, and volatility in, the results of our quantitative market-making and program trading portfolios; changes in payments for order flow rates and clearing costs; the addition or loss of executive management and asset management, equity sales and trading and technology professionals; legislative, legal and regulatory changes; legal and regulatory matters; geopolitical risk; the amount and timing of capital expenditures and divestitures; the incurrence of costs associated with acquisitions and dispositions; the integration, performance and operation of acquired businesses; investor sentiment; the level of assets under management and fund returns; technological changes and events; seasonality; competition; and market and economic conditions. Such factors may also have an impact on our ability to achieve our strategic objectives, including, without limitation, increases in our institutional market share and revenue capture in our Equity Markets segment and increases in our fund returns and assets under management in our Asset Management segment. If demand for our services declines in either of our segments due to any of the above factors, and we are unable to adjust our cost structure on a timely basis, our operating results and strategic objectives could be materially and adversely affected.

As a result of the foregoing factors, period-to-period comparisons of our revenues and operating results are not necessarily meaningful and such comparisons cannot be relied upon as indicators of future performance. There also can be no assurance that we will be able to return to the rates of revenue growth that we have experienced in the past or that we will be able to improve our operating results.

Trends

We believe that our continuing operations are currently impacted by the following trends that may affect our financial condition and results of operations.

Over the past three years, the effects of market structure changes, competition and market conditions have resulted in a decline in revenue capture per U.S. equity dollar value traded in our Equity Markets operations.

Retail broker-dealer participation in the equity markets has fluctuated over the past few years due to investor sentiment, market conditions and a variety of other factors. Retail transaction volumes may not be sustainable and are not predictable.

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Broker-dealer clients continue to focus on statistics measuring the quality of equity executions (including speed of executions and price improvement). In an effort to improve the quality of their executions as well as increase efficiencies, market makers have increased the level of automation within their operations. The greater focus on execution quality has resulted in greater competition in the marketplace, which has negatively impacted the revenue capture metrics of the Company and other market-making firms.

Market structure changes, competition and market conditions have triggered an industry shift toward market makers charging explicit commissions or commission equivalents to institutional clients for executions in OTC securities. For the majority of our institutional client orders, we currently charge an explicit fee in the form of commissions or commission equivalents. In addition, institutional commission rates have fallen in the past few years, and this may continue in the future.

Due to regulatory scrutiny over the past two years relating to equity sell-side research and the continued focus by investors on execution quality and overall transaction costs, more institutional clients allocate commissions to broker-dealers based on the quality of executions. In the past, institutional equity commissions were primarily allocated to broker-dealers in exchange for either research or soft dollar and commission recapture programs.

Market structure changes, competition and market conditions have resulted in the recent announcement of two significant mergers amongst U.S. market centers. This consolidation may result in greater competition in the future.

There has been increased scrutiny of market makers, hedge funds and soft dollar practices by the regulatory and legislative authorities, including regulation related to the registration of hedge funds. New legislation or modifications to existing regulations and rules could occur in the future.

There has been a growing trend among institutions to allocate more of their assets to hedge fund investments. This has influenced the growth in the hedge fund industry and may result in greater competition in the future.

Income Statement Items

The following section briefly describes the key components of, and drivers to, our significant revenues and expenses from continuing operations.

Revenues

Our revenues consist principally of Commissions and fees and Net trading revenue from U.S. securities trading and market-making activities from Equity Markets. Revenues on transactions for which we charge explicit commissions or commission equivalents, which includes the majority of our institutional client orders, are included within Commissions and fees. Commissions and fees are primarily affected by changes in our equity transaction volumes with institutional clients, changes in commission rates, the growth of our soft dollar and commission recapture activity as well as by changes in fees earned for directing trades to certain destinations for execution. We also receive fees for providing certain information to market data providers and for directing trades to certain destinations for execution.

Trading profits and losses on principal transactions are included within Net trading revenue. These revenues are primarily affected by changes in the amount and mix of U.S. equity trade and share volumes, our revenue capture, dollar value of equities traded, our ability to derive trading gains by taking proprietary positions, changes in our execution standards, volatility in the marketplace, industry commission levels, our mix of broker-dealer and institutional clients, and regulatory changes and evolving industry customs and practices.

Asset management fees represent fees earned by Deephaven Capital Management LLC (Deephaven) for sponsoring and managing the Deephaven Funds. These fees consist of annual management fees, calculated as

fixed percentages of assets under management, and incentive fees, which, in general, are calculated as a percentage of the funds annual returns. Such fees are primarily affected by the rates of return earned on the Deephaven Funds and changes in the amount of assets under management.

We earn interest income from our cash held at banks and cash held in trading accounts at clearing brokers. The Company s clearing agreements call for payment or receipt of interest income, net of transaction-related interest charged by clearing brokers for facilitating the settlement and financing of securities transactions. Net interest is primarily affected by interest rates, the changes in cash balances held at banks and clearing brokers and our level of securities positions in which we are long compared to our securities positions in which we are short.

Investment income and other income primarily represents income earned, net of losses, related to our corporate investment in the Deephaven Funds and our strategic investments. Such income is primarily affected by the rates of return earned by the Deephaven Funds as well as the performance and activity of our strategic investments.

Expenses

Our operating expenses largely consist of Employee compensation and benefits, Execution and clearance fees, Soft dollar and commission recapture payments and Payments for order flow. Employee compensation and benefits expense fluctuates, for the most part, based on changes in our revenues, our profitability and the number of employees. Execution and clearance fees primarily fluctuate based on changes in equity trade and share volume, clearance fees charged by clearing brokers and fees paid to access ECNs, exchanges and certain regulatory bodies. Soft dollar and commission recapture payments fluctuate based on U.S. equity share volume executed on behalf of institutions. Payments for order flow fluctuate based on U.S. equity share volume, profitability, the mix of market orders and limit orders, the mix of orders received from broker-dealers and institutions who accept payments for order flow and changes in our payment for order flow rates.

Employee compensation and benefits expense primarily consists of salaries and wages paid to all employees and profitability-based compensation, which includes compensation paid to sales personnel and incentive compensation paid to all other employees based on our overall profitability. Compensation for employees engaged in sales activities is determined primarily based on a percentage of their gross revenues net of certain expenses including soft dollar and commission recapture expenses, execution and clearance costs and overhead allocations. The majority of compensation in Asset Management is determined by a profitability-based formula, subject to certain minimum guaranteed payments.

Execution and clearance fees primarily represent clearance fees paid to clearing brokers for equities transactions, transaction fees paid to Nasdaq and other regional exchanges and regulatory bodies and execution fees paid to third parties, primarily for executing trades in listed securities on the New York Stock Exchange (NYSE) and American Stock Exchange (AMEX), and for executing orders through ECNs.

Soft dollar and commission recapture expense represent payments to institutions in connection with our soft dollar and commission recapture programs.

Payments for order flow represent payments to broker-dealer clients, in the normal course of business, for directing to us their order flow in U.S. equities. Payments for order flow fluctuate as we modify our payment rates and as the percentage of clients whose policy is not to accept payments for order flow varies.

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Three Months Ended September 30, 2005 and 2004

Continuing Operations

Revenues

	For the three months ended September 30,			
	2005	**2004**	**Change**	**% of Change**
Total Revenues from Asset Management (in millions)	$ 42.3	$ 6.8	$ 35.5	521.5%
Average month-end balance of assets under management (millions)	$ 3,374.6	$ 3,415.5	$ (40.9)	-1.2%
Quarterly fund return to investors*	5.5%	-0.5%	5.9%	NM

* Quarterly fund return represents the blended quarterly return across all assets under management in the Deephaven Funds
NM - Not meaningful

Total revenues from the Asset Management segment, which primarily consists of Asset management fees, increased to $42.3 million for the three months ended September 30, 2005, from $6.8 million for the comparable period in 2004. The increase is primarily due to higher incentive fees as a result of the increase in fund returns. The average month-end balance of assets under management was approximately $3.4 billion for the three months ended September 30, 2005 and 2004. The blended quarterly fund return across all assets under management for the three months ended September 30, 2005 was a gain of 5.5%, up from a loss of 0.5% for the comparable period in 2004.

	For the three months ended September 30,			
	2005	**2004**	**Change**	**% of Change**
Commissions and fees (millions)	$ 74.9	$ 58.6	$ 16.3	27.8%
Net trading revenue (millions)	52.3	35.9	16.4	45.8%
Interest and dividends, net (millions)	1.9	1.0	0.8	82.0%
Investment income and other (millions)	0.4	(0.1)	0.5	-433.5%
Total Revenues from Equity Markets (millions)	$ 129.4	$ 95.4	$ 34.0	35.6%
U.S equity dollar value traded ($ billions)	467.7	333.1	134.6	40.4%
U.S. equity trades executed (millions)	50.8	41.6	9.2	22.1%
Nasdaq and Listed equity shares traded (billions)	25.7	22.5	3.2	14.0%
OTC Bulletin Board and Pink Sheet shares traded (billions)	131.7	294.2	(162.5)	-55.2%
Average revenue capture per U.S. equity dollar value traded (bps)	2.0	2.2	(0.2)	-8.6%

Total revenues from our Equity Markets segment, which primarily comprises Commissions and fees and Net trading revenue from our domestic businesses, increased 35.6% to $129.4 million for the three months ended September 30, 2005, from $95.4 million for the comparable period in 2004. The increase in revenues was primarily the result of higher dollar volumes traded, which increased 40.4% compared to the three months ended September 30, 2004, and the acquisition of DTI at the end of the second quarter offset, in part, by a decrease in revenue capture per U.S. equity dollar value traded.

Average revenue capture per U.S. equity dollar value traded was 2.0 basis points (bps) for the third quarter of 2005, down 8.6% from 2.2 bps in the third quarter of 2004. Average revenue capture per U.S. equity dollar value traded is calculated as the total of net trading revenues less certain transaction-related regulatory fees (included in Execution and clearance fees) and institutional commissions and commission equivalents (included in Commissions and fees), (collectively, Core Equity Revenues) divided by the total dollar value of the related equity transactions. Core Equity Revenues were $92.1 million and $71.7 million for the three months ended September 30, 2005 and 2004, respectively.

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	For the three months ended September 30,			
	2005	2004	Change	% of Change
Total Revenues from Corporate (millions)	$ 12.4	$ (0.4)	$ 12.8	NM
Average corporate investment balance in the Deephaven Funds (millions)	$ 278.7	$ 206.7	$ 72.0	34.8%

NM - Not meaningful

Total revenues from the Corporate segment, which primarily represents income from our corporate investment in the Deephaven Funds and other strategic investments, increased $12.8 million. Income from our corporate investment in the Deephaven Funds increased to a gain of $14.6 million for the three months ended September 30, 2005, from a loss of $1.6 million for the comparable period in 2004.

Expenses

Employee compensation and benefits expense increased 36.2% to $68.3 million for the three months ended September 30, 2005, from $50.1 million for the comparable period in 2004. As a percentage of total revenue, employee compensation and benefits decreased to 37.1% for the three months ended September 30, 2005, from 49.2% in the comparable period in 2004. The increase on a dollar basis was primarily due to the increase in overall profitability. Our number of full time employees within our continuing operations increased to 699 at September 30, 2005, from 675 full time employees at September 30, 2004, primarily due to the acquisition of DTI. In addition, we incurred severance costs of $1.9 million and $870,000 for the three months ended September 30, 2005 and 2004, respectively.

Execution and clearance fees increased 11.5% to $24.6 million for the three months ended September 30, 2005, from $22.0 million for the comparable period in 2004. As a percentage of total revenue, execution and clearance fees decreased to 13.4% for the three months ended September 30, 2005, from 21.6% in the comparable period in 2004. Execution and clearance fees fluctuate based on changes in transaction volumes, regulatory fees and efficiencies in processing the transactions. As a percentage of revenues, execution and clearance fees decreased primarily due to higher asset management revenues, which have no associated execution and clearance fees.

Payments for order flow decreased 15.3% to $3.9 million for the three months ended September 30, 2005, from $4.6 million for the comparable period in 2004. As a percentage of total revenue, payments for order flow decreased to 2.1% for the three months ended September 30, 2005, from 4.5% for the comparable period in 2004. The decrease on a dollar basis and as a percentage of total revenue was primarily due to changes in our payment for order flow rates. Soft dollar and commission recapture expense increased 11.1% to $15.9 million for the three months ended September 30, 2005, from $14.3 million for the comparable period in 2004.

Communications and data processing expense increased slightly to $8.0 million for the three months ended September 30, 2005, from $7.9 million for the comparable period in 2004.

Depreciation and amortization expense increased 24.1% to $4.2 million for the three months ended September 30, 2005, from $3.4 million for the comparable period in 2004. This increase was primarily due to the amortization of intangible assets related to the purchase of the business of

DTI as well as additional depreciation and amortization expense related to new fixed assets and leasehold improvements at our new corporate headquarters at 545 Washington Boulevard in Jersey City, N.J.

Occupancy and equipment rentals expense decreased 21.8% to $3.2 million for the three months ended September 30, 2005, from $4.1 million for the comparable period in 2004. This decrease was primarily attributable to the lease loss accruals recorded during the second quarter of 2005 related to our move from 525 Washington Boulevard into our new facility at 545 Washington Boulevard in Jersey City, N.J.

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Professional fees increased to $6.1 million for the three months ended September 30, 2005, from $4.3 million for the comparable period in 2004. The increase in 2005 was primarily due to increases in consulting expenses and legal expenses, which have fluctuated based on the activity surrounding our various legal and regulatory matters.

Business development expense decreased to $1.6 million for the three months ended September 30, 2005, from $2.1 million for the comparable period in 2004. The primary reasons for the decrease were lower advertising and travel and entertainment costs.

Other expenses increased to $2.8 million for the three months ended September 30, 2005, from a benefit of $820,000 for the comparable period in 2004. This increase was due to a one-time benefit, in the comparable period in 2004, of approximately $3.0 million related to an adjustment to legal reserves. Excluding this one-time benefit, Other expenses would have increased 27.8% due to an increase in administrative and other costs relating to the move to our new headquarters at 545 Washington Boulevard, Jersey City, N.J.

During the three months ended September 30, 2005, a charge of $5.5 million was incurred related to our Equity Markets segment. This charge consisted of a lease loss accrual related to excess real estate capacity at our 545 Washington Boulevard facility in Jersey City, N.J. During the three months ended September 30, 2004, a charge of $874,000 was incurred related to our Equity Markets segment. This charge related to the writedown of fixed assets that were no longer actively used.

Our effective income tax rates, from continuing operations, of 40.2% and 39.8% for the three months ended September 30, 2005 and 2004, respectively, differ from the federal statutory income tax rate of 35% due primarily to state income taxes and nondeductible charges.

Discontinued Operations

As of the close of business on December 9, 2004, the Company sold substantially all of the assets and certain of the liabilities that comprised the Derivative Markets segment operated by Knight Financial Products LLC and Knight Execution Partners LLC to Citigroup for approximately $237 million in cash. The final purchase price was subject to adjustment based on the final determination of book value of the Derivative Markets business at the time the deal closed. The decision to sell the Derivative Markets business was based on a review of the overall options industry, the capital and risk required to maintain this business successfully and the business role in the Company s long-term strategy. The Company recognized a small after-tax gain of $388,000 related to its former Derivative Markets business in the three months ended September 30, 2005. The Income from discontinued operations, net of tax on the Consolidated Statements of Operations was $5.3 million for the three months ended September 30, 2004. For a further discussion of the sale of the Company s Derivative Markets business, please see Footnote 9 Discontinued Operations included in Part I, Item 1 Financial Statements of this document.

Nine Months Ended September 30, 2005 and 2004

Continuing Operations

Revenues

	For the nine months ended September 30,			
	2005	2004	Change	% of Change
Total Revenues from Asset Management (millions)	$ 68.3	$ 28.9	$ 39.4	136.0%
Average month-end balance of assets under management (millions)	$ 3,372.2	$ 2,756.4	$ 615.8	22.3%
Year-to-date fund return to investors*	5.2%	1.6%	3.6%	225.0%

* Year-to-date fund return represents the blended year-to-date return across all assets under management in the Deephaven Funds

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Total revenues from the Asset Management segment, which primarily consists of Asset management fees, increased 136.0% to $68.3 million for the nine months ended September 30, 2005, from $28.9 million for the comparable period in 2004. The increase is primarily due to higher incentive fees as a result of an increase in fund returns as well as higher management fees due to the growth in assets under management. The blended year-to-date fund return across all assets under management for the nine months ended September 30, 2005 was a gain of 5.2%, up from a gain of 1.6% for the comparable period in 2004. The average month-end balance of assets under management increased to $3.4 billion for the nine months ended September 30, 2005, from $2.8 billion for the comparable period in 2004.

	For the nine months ended September 30,			
	2005	2004	Change	% of Change
Commissions and fees (millions)	$ 213.0	$ 203.8	$ 9.2	4.5%
Net trading revenue (millions)	116.8	197.9	(81.0)	-41.0%
Interest and dividends, net (millions)	3.7	2.5	1.2	48.2%
Investment income and other (millions)	2.4	0.3	2.1	780.3%
Total Revenues from Equity Markets (millions)	$ 335.9	$ 404.4	$ (68.6)	-17.0%
U.S equity dollar value traded ($ billions)	1,384.1	1,254.5	129.6	10.3%
U.S. equity trades executed (millions)	151.8	150.2	1.6	1.0%
Nasdaq and Listed equity shares traded (billions)	80.2	92.7	(12.5)	-13.5%
OTC Bulletin Board and Pink Sheet shares traded (billions)	581.5	990.6	(409.1)	-41.3%
Average revenue capture per U.S. equity dollar value traded (bps)	1.7	2.6	(0.8)	-31.7%

Total revenues from our Equity Markets segment, which primarily comprises Commissions and fees and Net trading revenue from our domestic businesses, decreased 17.0% to $335.9 million for the nine months ended September 30, 2005, from $404.4 million for the comparable period in 2004. The decrease in revenues was primarily the result of lower revenue capture per U.S. equity dollar value traded and lower share volumes.

Average revenue capture per U.S. equity dollar value traded was 1.7 bps for the first nine months of 2005, down 31.7% from 2.6 bps in the first nine months of 2004. We attribute the decrease in average revenue capture per U.S. equity dollar value traded to an increase in competition over the past year and market conditions. Core Equity Revenues were $241.3 million and $320.1 million for the nine months ended September 30, 2005 and 2004, respectively.

	For the nine months ended September 30,			
	2005	2004	Change	% of Change
Total Revenues from Corporate (millions)	$ 29.2	$ 6.8	$ 22.4	328.0%
Average corporate investment balance in the Deephaven Funds (millions)	$ 270.9	$ 218.7	$ 52.2	23.9%

Total revenues from the Corporate segment, which primarily represents income from our corporate investment in the Deephaven Funds and other strategic investments, increased $22.4 million. The increase is primarily due to gains on the sale of our equity investments in Nasdaq and the ISE as well as our corporate investment in the Deephaven Funds. On March 9, 2005, in conjunction with the ISE s initial public offering, the Company sold approximately 30% of its original equity ownership in the ISE. As a result of the transaction, the Company recognized a pre-tax gain of $9.6 million. The Company also recognized a pre-tax gain of $5.9 million from our investments in Nasdaq. Income from our corporate

investment in the Deephaven Funds increased to a gain of $11.5 million for the nine months ended September 30, 2005, from a gain of $3.8 million for the comparable period in 2004. The increase is due to higher average returns on a larger average corporate investment balance.

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Expenses

Employee compensation and benefits expense increased 2.9% to $173.3 million for the nine months ended September 30, 2005, from $168.5 million for the comparable period in 2004. As a percentage of total revenue, employee compensation and benefits increased to 40.0% for the nine months ended September 30, 2005, from 38.3% in the comparable period in 2004. The increase on a dollar basis was primarily due to the increase in profitability within the Asset Management segment as well as an increase in the number of employees within our continuing operations. Our number of full time employees within our continuing operations increased to 699 at September 30, 2005, from 675 full time employees at September 30, 2004, primarily due to the acquisition of DTI. In addition, we incurred severance costs of $5.8 million and $2.9 million for the nine months ended September 30, 2005 and 2004, respectively.

Execution and clearance fees decreased 19.2% to $71.5 million for the nine months ended September 30, 2005, from $88.5 million for the comparable period in 2004. As a percentage of total revenue, execution and clearance fees decreased to 16.5% for the nine months ended September 30, 2005, from 20.1% for the comparable period in 2004. Execution and clearance fees fluctuate based on changes in transaction volumes, regulatory fees and efficiencies in processing the transactions. The decrease as a percentage of total revenue was primarily due to higher asset management fees, which have no associated execution and clearance fees.

Payments for order flow decreased 45.9% to $14.8 million for the nine months ended September 30, 2005, from $27.4 million for the comparable period in 2004. As a percentage of total revenue, payments for order flow decreased to 3.4% for the nine months ended September 30, 2005, from 6.2% for the comparable period in 2004. The decrease on a dollar basis was primarily due to changes in our payment for order flow rates. Soft dollar and commission recapture expense increased 3.9% to $46.0 million for the nine months ended September 30, 2005, from $44.3 million for the comparable period in 2004.

Communications and data processing expense increased 10.9% to $23.9 million for the nine months ended September 30, 2005, from $21.6 million for the comparable period in 2004. This increase was primarily attributable to an increase in technology costs related to our Equity Markets segment.

Depreciation and amortization expense increased 12.7% to $12.2 million for the nine months ended September 30, 2005, from $10.9 million for the comparable period in 2004. This increase was primarily due to additional depreciation and amortization expense related to new fixed assets and leasehold improvements at our new corporate headquarters at 545 Washington Boulevard in Jersey City, N.J. as well as the amortization of intangible assets related to the purchase of the business of DTI.

Occupancy and equipment rentals expense decreased 20.9% to $10.2 million for the nine months ended September 30, 2005, from $12.9 million for the comparable period in 2004. This decrease was primarily attributable to the lease loss accruals recorded during the second quarter of 2005 related to our move from 525 Washington Boulevard into our new facility at 545 Washington Boulevard in Jersey City, N.J. and a $750,000, pre-tax, one-time benefit relating to a reduction of certain lease obligations at our former London office site.

Professional fees increased to $14.4 million for the nine months ended September 30, 2005, from $11.6 million for the comparable period in 2004. The increase in 2005 was primarily due to an increase in consulting and legal expenses, which have fluctuated based on the activity surrounding our various legal and regulatory matters.

Business development expense decreased to $4.6 million for the nine months ended September 30, 2005, from $5.9 million for the comparable period in 2004. The primary reasons for the decrease were lower travel and entertainment costs.

Other expenses increased to $8.9 million for the nine months ended September 30, 2005, from $4.1 million for the comparable period in 2004. This increase was primarily due to a one-time benefit, in the comparable period in 2004, of approximately $3.0 million related to an adjustment to legal reserves. Excluding this one-time benefit, Other expenses would have increased 24.5% due to administrative and other costs relating to the move to our new headquarters at 545 Washington Boulevard in Jersey City, N.J.

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During the nine months ended September 30, 2005, we recorded charges of $12.1 million. These charges consisted of $5.5 million of a lease loss accrual related to excess real estate capacity at our 545 Washington Boulevard facility in Jersey City, N.J. and $4.5 million of lease loss accrual related to our move from 525 Washington Boulevard into our new facility at 545 Washington Boulevard in Jersey City, N.J. within our Equity Markets segment and $2.0 million of Regulatory charges and related matters within our Asset Management segment. During the nine months ended September 30, 2004, we recorded charges of $82.7 million within our Equity Markets segment. These charges primarily consisted of $79.2 million of Regulatory charges and related matters and $2.6 million of lease loss accrual related to the cost associated with our excess real estate capacity at our 545 Washington Boulevard facility in Jersey City, N.J. For a discussion of the Regulatory charges and related matters, refer to Footnote 11 in the Consolidated Financial Statements included in Part I, Item 1 Financial Statements of this document.

Our effective income tax rates, from continuing operations, of 41.1% and 15.6% for the nine months ended September 30, 2005 and 2004, respectively, differ from the federal statutory income tax rate of 35% due primarily to state income taxes and nondeductible charges.

Discontinued Operations

The Income from discontinued operations, net of tax on the Consolidated Statements of Operations was $122,000 and $14.9 million for the nine months ended September 30, 2005 and 2004, respectively. For a further discussion of the sale of the Company s Derivative Markets business, please see Footnote 9 Discontinued Operations included in Part I, Item 1 Financial Statements of this document.

Reconciliation of Total GAAP Expenses and Pre-Tax GAAP Income to Operating Expenses and Pre-Tax Operating Earnings, Respectively

In an effort to provide additional information regarding the Company s results as determined by GAAP, the Company also discloses certain non-GAAP information which management believes provides useful information to investors. Within this Form 10-Q, the Company has disclosed its Operating Expenses and Pre-Tax Operating Earnings to assist the reader in understanding the impact of the Regulatory charges and related matters and the Writedown of assets and lease loss accrual on the Company s quarterly and year-to-date results for 2005 and 2004 by segment, thereby facilitating more useful period-to-period comparisons of the Company s continuing businesses. For additional information related to segments, please see Footnote 16 Business Segments included within Part I, Item I Financial Statements of this document. Charts are presented in millions.

Total GAAP Expenses to Operating Expenses

	For the three months ended September 30, 2005				For the three months ended September 30, 2004			
	Equity Markets	Asset Mgmt	Corporate	Total	Equity Markets	Asset Mgmt	Corporate	Total
Total GAAP Expenses	$ 110.3	$ 26.5	$ 7.1	$ 144.0	$ 98.7	$ 7.3	$ 6.8	$ 112.8
Writedown of assets and lease loss accrual	(5.5)			(5.5)	(0.9)			(0.9)

Operating Expenses	$ 104.8	$ 26.5	$ 7.1	$ 138.5	$ 97.8	$ 7.3	$ 6.8	$ 111.9

	For the nine months ended September 30, 2005				For the nine months ended September 30, 2004			
	Equity Markets	Asset Mgmt	Corporate	Total	Equity Markets	Asset Mgmt	Corporate	Total
Total GAAP Expenses	$ 323.8	$ 50.3	$ 17.8	$ 391.9	$ 432.7	$ 21.6	$ 24.0	$ 478.3
Regulatory charges and related matters		(2.0)		(2.0)	(79.2)			(79.2)
Writedown of assets and lease loss accrual	(10.0)			(10.0)	(3.5)			(3.5)
Operating Expenses	$ 313.8	$ 48.3	$ 17.8	$ 379.9	$ 350.0	$ 21.6	$ 24.0	$ 395.6

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Pre-Tax GAAP Income to Pre-Tax Operating Earnings

	For the three months ended September 30, 2005				For the three months ended September 30, 2004			
	Equity Markets	Asset Mgmt	Corporate	Total	Equity Markets	Asset Mgmt	Corporate	Total
Pre-Tax GAAP Income (Loss)	$ 19.1	$ 15.7	$ 5.3	$ 40.1	$ (3.3)	$ (0.5)	$ (7.2)	$ (11.0)
Writedown of assets and lease loss accrual	5.5			5.5	0.9			0.9
Pre-Tax Operating Earnings	$ 24.6	$ 15.7	$ 5.3	$ 45.6	$ (2.4)	$ (0.5)	$ (7.2)	$ (10.1)

	For the nine months ended September 30, 2005				For the nine months ended September 30, 2004			
	Equity Markets	Asset Mgmt	Corporate	Total	Equity Markets	Asset Mgmt	Corporate	Total
Pre-Tax GAAP Income (Loss)	$ 12.1	$ 17.9	$ 11.3	$ 41.4	$ (28.3)	$ 7.3	$ (17.2)	$ (38.2)
Regulatory charges and related matters		2.0		2.0	79.2			79.2
Writedown of assets and lease loss accrual	10.0			10.0	3.5			3.5
Pre-Tax Operating Earnings	$ 22.1	$ 20.0	$ 11.3	$ 53.4	$ 54.4	$ 7.3	$ (17.2)	$ 44.5

- Totals may not add due to roundings.

Liquidity and Capital Resources

Historically, we have financed our business primarily through cash generated by operations, as well as the proceeds from our stock issuances and, in 2004, from the proceeds from the sale of our Derivative Markets segment. As of September 30, 2005, we had $1.4 billion in assets, 59% of which consisted of cash or assets readily convertible into cash, principally receivables from brokers and dealers and securities owned. Receivables from brokers and dealers include interest bearing cash balances held with clearing brokers, including, or net of, amounts related to securities transactions that have not yet reached their contracted settlement date, which is generally within three business days of the trade date. Securities owned principally consist of equity securities that trade in Nasdaq, on the OTC Bulletin Board and on the NYSE and AMEX markets. At September 30, 2005, the Company had net current assets, which consist of net assets readily convertible into cash, of approximately $207.6 million. Additionally, our corporate investment in the Deephaven Funds was $281.8 million at September 30, 2005. The majority of this investment can be liquidated upon request subject to a ninety-day written notification period and monthly redemption limits, or immediately by invoking our rights as the general partner of the Deephaven Funds.

The Company has previously disclosed its intent to pursue selective acquisitions of (or possible joint ventures with) complementary businesses primarily in the markets in which our Equity Markets and Asset Management segments operate. We expect to fund the purchase price of any such acquisition with our current cash position or, in some cases, through the issuance of the Company s stock. In April 2005, the Company announced that it had reached an agreement to acquire, for cash, the business of Direct Trading Institutional, Inc. (now operating as DTI), a privately held firm specializing in providing institutions with direct access trading through an advanced electronic platform. The transaction subsequently closed in June 2005 with a $40 million initial cash payment. Additionally, in May 2005, the Company announced that it had reached an agreement to acquire, for cash, the business of the ATTAIN ECN, an alternative trading system that operates an electronic communications network (ECN) for the trading of Nasdaq securities. The transaction subsequently closed in October 2005. No assurance can be given with respect to the business effect of these transactions or the timing, likelihood or business effect of any other possible transaction.

As discussed elsewhere in this document, we sold our Derivative Markets business for approximately $237 million in cash as of the close of business on December 9, 2004. The final purchase price was subject to

adjustment based on the final determination of the book value of the Derivative Markets business at the time the deal closed. The final purchase price, in addition to other expenses related to the sale, was finalized in the first quarter of 2005.

Income (loss) from continuing operations before income taxes was $40.1 million and ($11.0 million) for the three months ended September 30, 2005 and 2004, respectively. Included in these amounts were certain non-cash expenses such as depreciation and amortization. Depreciation expense from continuing operations was $3.5 million and $3.2 million for the three months ended September 30, 2005 and 2004, respectively. Amortization expense from continuing operations, which related to intangible assets, was $735,000 and $155,000 for the three months ended September 30, 2005 and 2004, respectively. Non-cash writedowns from continuing operations consisted of $874,000 for the three months ended September 30, 2004. There were no non-cash writedowns for the three months ended September 30, 2005.

Net proceeds from (purchases of) strategic investments were $674,000 and ($332,000) for the three months ended September 30, 2005 and 2004, respectively. Our corporate investment in the Deephaven Funds increased by $54.6 million for the three months ended September 30, 2005 compared to a decrease of $1.6 million during the three months ended September 30, 2004. The change in the balance of our corporate investment in the Deephaven Funds for the three months ended September 30, 2005 primarily relates to the Company s additional investment of $40.0 million made on July 1, 2005, as well as a positive return on our investments of $14.6 million. The change in the balance of our corporate investment in the Deephaven Funds for the three months ended September 30, 2004 related to a loss on our investments of $1.6 million.

Capital expenditures related to our continuing operations were $5.2 million and $19.3 million during the three months ended September 30, 2005 and 2004, respectively. Capital expenditures primarily relate to the purchase of leaseholds and other fixed assets related to the buildout of our new headquarters at 545 Washington Boulevard in Jersey City, N.J. We began the process of moving our Jersey City, N.J. offices to 545 Washington Boulevard during the first quarter of 2005 and completed the move by the end of the second quarter of 2005.

At its October 18, 2005 meeting, the Board of Directors authorized an additional increase in the size of the Company s stock repurchase program from $320 million to $345 million. The Company repurchased 5.3 million shares during the third quarter of 2005 for a total cost of $43.9 million. Through September 30, 2005, the Company had repurchased 37.6 million shares for $295.9 million under its stock repurchase program. The Company may repurchase shares in the open market or through privately negotiated transactions, depending on prevailing market conditions, alternative uses of capital and other factors. The Company cautions that there are no assurances that any further repurchases may actually occur. The Company had approximately 102.0 million shares of Class A Common Stock outstanding as of September 30, 2005.

As U.S. registered broker-dealers, Knight Equity Markets, L.P. (KEM), Knight Capital Markets LLC (KCM) and Direct Trading Institutional, L.P. (DTI) are subject to regulatory requirements intended to ensure the general financial soundness and liquidity of broker-dealers and requiring the maintenance of minimum levels of net capital, as defined in SEC Rule 15c3-1. These regulations also prohibit a broker-dealer from repaying subordinated borrowings, paying cash dividends, making loans to its parent, affiliates or employees, or otherwise entering into transactions which would result in a reduction of its total net capital to less than 120.0% of its required minimum capital. Moreover, broker-dealers, including KEM, KCM and DTI, are required to notify the SEC prior to repaying subordinated borrowings, paying dividends and making loans to its parent, affiliates or employees, or otherwise entering into transactions, which, if executed, would result in a reduction of 30.0% or more of its excess net capital (net capital less minimum requirement). The SEC has the ability to prohibit or restrict such transactions if the result is detrimental to the financial integrity of the broker-dealer. Additionally, Knight Equity Markets International Ltd. (KEMIL) is subject to capital adequacy requirements of the Financial Services Authority in the United Kingdom. The following table sets forth the net capital levels and requirements for the following significant broker-dealer subsidiaries at September 30, 2005, as filed in their respective regulatory filings (in millions):

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Entity	Net Capital	Minimum Net Capital	Excess Net Capital
KEM	$ 82.8	$ 5.5	$ 77.3
KCM	34.9	1.0	33.9
KEMIL	20.4	6.8	13.6
DTI	5.5	0.9	4.6

We have no long-term debt at September 30, 2005 nor do we currently have any material long-term debt commitments for the rest of 2005. We currently anticipate that available cash resources and credit facilities will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months.

Off-Balance Sheet Arrangements

As of September 30, 2005, we did not have any off-balance sheet arrangements, as defined in Item 303 (a) (4) (ii) of SEC Regulation S-K.

Critical Accounting Policies

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions. We believe that, of our significant accounting policies, the following policies involve a higher degree of judgment.

Lease Loss Accrual It is the Company s policy to identify excess real estate capacity and where applicable, accrue for such future costs. In determining the accrual, a nominal cash flow analysis is performed for lease losses initiated prior to December 31, 2002, the effective date of SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities,* and costs related to the excess capacity are accrued. For lease losses initiated after December 31, 2002, the Company s policy is to accrue future costs related to excess capacity using a discounted cash flow analysis. Based on the results of an analysis of the current accrual and market conditions, which was performed during the period, an additional accrual, related to excess real estate capacity at our location at 545 Washington Boulevard in Jersey City, New Jersey, of $5.5 million was recorded in the third quarter of 2005. The majority of the lease loss accrual charges taken to date are related to a portion of our lease at 545 Washington Boulevard in Jersey City, New Jersey, encompassing approximately 78,000 square feet, all of which is unoccupied. The Company engaged a real estate broker in order to sub-lease this excess space based on an assessment of our real estate needs. The analysis of our accrual was derived from assumptions and estimates based on lease terms of projected sub-lease agreements, which assumed a sub-lease will have commenced at the beginning of 2007, anticipated market prices along the Jersey City waterfront and estimated up-front costs, including broker fees and build out allowances. We continually monitor the market and space to assess the reasonableness of our applicable assumptions.

Impairment of Goodwill and Intangible Assets The useful lives of goodwill and intangible assets are determined upon acquisition. Intangible assets are amortized over their respective lives. Goodwill and the useful lives of intangible assets are tested for impairment, at a minimum, on an annual basis, or when an event occurs or circumstances change that signify the existence of impairment.

Our Goodwill of $39.9 million as of September 30, 2005, related to our Equity Markets segment. During our annual tests for impairment done in June 2005, it was determined that these assets were not impaired. As part of our test for impairment, we considered the profitability of the

applicable reporting unit, an assessment of fair value of the reporting unit based on various valuation methodologies, as well as the overall market value of the Company, compared to the Company s book value.

Our Intangible assets, less accumulated amortization, of $30.5 million as of September 30, 2005, related to our Equity Markets segment. These assets, which primarily consist of client relationships, are being amortized on a straight-line basis over their useful lives, which have been determined to range from two to thirty years. During our annual tests for impairment done in June 2005, it was determined that there was no impairment to these intangible assets.

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Strategic Investments Investments include ownership interests of less than 20% in financial services-related businesses, which are accounted for under the equity method or at fair value. The equity method of accounting is used for investments in limited partnerships and limited liability corporations. The fair value of investments, recorded in the Company s broker-dealer subsidiaries, for which a quoted market or dealer price is not available for the size of our investment is based on management s estimate. Among the factors considered by management in determining the fair value of investments are the cost of the investment, terms and liquidity, developments since the acquisition of the investment, the sales price of recently issued securities, the financial condition and operating results of the issuer, earnings trends and consistency of operating cash flows, the long-term business potential of the issuer, the quoted market price of securities with similar quality and yield that are publicly traded, and other factors generally pertinent to the valuation of investments. The fair value of these investments is subject to a high degree of volatility and may be susceptible to significant fluctuations in the near term. Strategic investments are reviewed on an ongoing basis to ensure that the carrying values of the investments have not been impaired. If the Company assesses that an impairment loss on the strategic investments has occurred due to declines in fair value or other market conditions, the investments are written down to its impairment value. As of September 30, 2005, the Company reviewed the strategic investment for impairment and determined that an impairment loss had not occurred.

Investments that are classified as available-for-sale are reported at fair value with unrealized gains and losses excluded from earnings and reported, net of applicable taxes, in Accumulated other comprehensive income, net of tax within Stockholders Equity on the Consolidated Statements of Financial Condition.

Investments not recorded in the Company s broker-dealer subsidiaries which do not have a readily determinable fair value, are recorded at amortized cost.

Market-Making Activities Securities owned and securities sold, not yet purchased, which primarily consist of listed and OTC stocks, are carried at market value and are recorded on a trade date basis. Market value is estimated daily using market quotations available from major securities exchanges and dealers.

Asset Management Fees The Company earns asset management fees for sponsoring and managing the Deephaven Funds. Such fees are recorded monthly as earned and are calculated as a percentage of the Deephaven Funds monthly net assets, plus a percentage of a new high net asset value (the Incentive Allocation Fee), as defined, for any six month period ended June 30th or December 31st. A new high net asset value is defined as the amount by which the net asset value of the Deephaven Funds exceeds the greater of either the highest previous net asset value in the Deephaven Funds or the net asset value at the time each investor made his purchase. The Incentive Allocation Fee may increase or decrease during the year based on the performance of the Deephaven Funds. If Deephaven s Market Neutral Fund, which contains the majority of the assets under management, recognizes a loss in the second half of a calendar year, the Incentive Allocation Fee is recalculated on an annual rather than a semi-annual basis. As such, the Incentive Allocation Fee may be negative for certain periods, but not lower than zero on a year-to-date basis.

Writedown of Fixed Assets Writedowns of fixed assets are recognized when it is determined that the fixed assets are impaired. The amount of the impairment is determined by the difference between the carrying amount and the fair value of the fixed asset. In determining the impairment, an estimated fair value is obtained through research and inquiry of the market. Fixed assets are reviewed for impairment on a quarterly basis.

Other Estimates The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates. In addition to the estimates noted in this section, the Company uses estimates in determining compensation and benefits expense for interim periods and in determining provisions for potential losses that may arise from litigation and regulatory proceedings.

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A portion of our Employee compensation and benefits expense on the Consolidated Statements of Operations represents discretionary bonuses, generally determined at year end and paid in the subsequent months. Among many factors, discretionary bonus accruals, in general, are influenced by the Company s overall performance and competitive industry compensation levels. Therefore, for each interim period, we accrue an amount based on this analysis.

We estimate and accrue for potential losses that may arise out of litigation and regulatory proceedings to the extent that such losses are probable and can be estimated in accordance with SFAS No. 5 *Accounting for Contingencies*. The amount accrued is determined on a case-by-case basis and represents an estimate of probable losses based on, among other factors, the progress of each case, our experience with and industry experience with similar cases and the opinions and views of legal counsel. As such, the total amount accrued may be materially different from the final outcome of such matters. For more information on our legal and regulatory matters, see Legal Proceedings in Part I, Item 3 of the Company s amended Annual Report on Form 10-K/A and Part II, Item 1 included in this document.

Recently Issued Accounting Standards

In December 2004, the FASB issued a revision to SFAS No. 123 *Accounting for Stock-Based Compensation*, SFAS No. 123-R, *Share-Based Payment*. SFAS No. 123-R focuses primarily on transactions in which an entity exchanges its equity instruments for employee services. SFAS No. 123-R eliminates the intrinsic value method under Accounting Principles Board No. 25 as an alternative method of accounting for stock-based awards. Additionally SFAS No. 123-R clarifies SFAS No. 123 s guidance in several areas including measuring fair value, classifying an award as equity or as a liability and attributing compensation cost to reporting periods. In April 2005, the SEC amended the effective date of compliance for FAS 123-R. This statement is effective for the fiscal year that begins after June 15, 2005. The Company plans on adopting the provisions of this statement for 2006. The Company currently applies APB 25 and related interpretations in accounting for its stock options plans.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

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

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

In the normal course of our equities market-making business, we maintain inventories of exchange-listed and OTC equity securities. The fair value of these securities at September 30, 2005 and 2004 was $367.8 million and $238.5 million, respectively, in long positions and $330.3 million and $228.7 million, respectively, in short

positions. The potential change in fair value, using a hypothetical 10.0% decline in prices, is estimated to be a $3.8 million loss and a $1.0 million loss as of September 30, 2005 and 2004, respectively, due to the offset of gains in short positions with the losses in long positions.

As of September 30, 2005, we had a $281.8 million corporate investment in the Deephaven Funds, $218.5 million of which was invested in the Market Neutral Fund. The general objective of market neutral investment strategies is to capture mispricings or spreads between related capital instruments. Within the Market Neutral Fund, Deephaven employs a variety of market neutral investment strategies, including convertible arbitrage, event arbitrage, relative value equity and distressed debt. Because the primary basis of the Deephaven Funds market neutral strategy is capturing mispricings or spreads between related instruments, rather than attempting to predict or follow absolute price movements, the performance of the Market Neutral Fund is expected to be substantially non-correlated with the general debt and equity markets, as well as with a number of other non-traditional investment strategies. However, there will be unhedged credit risk in the convertible arbitrage portfolio and that part of the portfolio will have some correlation to credit spreads. Market neutral trading strategies also involve other substantial risks such as the disruption in historical pricing relationships and the risk of a tightening of dealer credit, forcing the premature liquidation of positions. The Deephaven Funds also utilize leverage, to the extent available and deemed by Deephaven to be consistent with the Funds risk/reward objectives, in an attempt to increase returns while maintaining strict risk controls.

The Deephaven Funds employ automated proprietary trading and position management systems that provide position management and inventory control. We monitor our risks by reviewing trading positions and their appropriate risk measures. We have established a system whereby transactions are monitored by management and an independent risk control function, as are individual and aggregate dollar and inventory position totals and profits and losses by strategy. The management of trading positions is enhanced by review of mark-to-market valuations and position summaries. There can be no assurances that the Deephaven Funds strategy will be successful in achieving either its risk control or its profit objectives.

Item 4. Controls and Procedures

As of the end of the period covered by this report, an evaluation was carried out under the supervision and with the participation of the Company s management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-14(c) under the Securities Exchange Act of 1934). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective. There have not been any changes in the Company s internal control over financial reporting (as such term is defined in Rule 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the last fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we and certain of our past and present officers, directors and employees have been named as parties to legal actions, securities arbitrations, administrative claims and regulatory reviews and investigations arising in connection with the conduct of our businesses. We are also subject to several of these matters at the present time. Although there can be no assurances, at this time the Company believes, based on information currently available, that the outcome of each of the matters will not have a material adverse effect on the consolidated financial condition of the Company, although they might be material to operating results for any particular period, depending, in part, upon operating results for that period.

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Legal

Short Selling Litigation:

During the third quarter of 2005, the following development occurred in the action entitled *ATSI v. The Shaar Fund, Ltd., et al*., described in the Company s Annual Report on Form 10-K/A for the year ended December 31, 2004:

On or about September 8, 2005, the Court entered an amended judgment certifying the matter for appeal pursuant to Federal Rule of Civil Procedure 54(b). Plaintiffs filed a notice of appeal on or about September 20, 2005.

KEM Trading Dispute Arbitration:

The following developments occurred in the *KEM Trading Dispute Arbitration* described in the Company s Annual Report on Form 10-K/A for the year ended December 31, 2004:

In the action pending in New York Supreme Court, on or about August 12, 2005, the court granted KEM s motion to dismiss the declaratory judgment action brought by the customer of KEM s counterparty involved in the KEM Trading Dispute Arbitration. On or about August 16, 2005, judgment was entered against that customer, and on or about September 13, 2005, that customer filed a notice of appeal from that dismissal. In the KEM Trading Dispute Arbitration, on or about October 21, 2005, KEM s counterparty asserted claims in the nature of an interpleader against its customer and KEM, requesting the panel determine the rights to the disputed dividends.

Other Litigation:

The following developments occurred in the actions entitled *Last Atlantis Capital LLC et al. v. Chicago Board Options Exchange, Inc. et al.* and *Rule v. Chicago Board Options Exchange, Inc. et al* , both as described in the Company s Annual Report on Form 10-K/A for the year ended December 31, 2004:

On or about October 5, 2005, the Court entered an order permitting the plaintiffs in *Last Atlantis* to file a second amended complaint, including adding two new plaintiffs, one of whom is the plaintiff in *Rule.* The same plaintiffs counsel has recently filed two additional, substantially identical cases on behalf of other plaintiffs, and has indicated his intention to transfer, as related, these cases to the same judge hearing *Last Atlantis*. Plaintiffs counsel has also indicated his intention, once that transfer is accomplished, to file a consolidated amended complaint on behalf of all plaintiffs.

Regulatory

The Company owns subsidiaries including regulated broker-dealers that are subject to extensive oversight under federal, state and applicable international laws as well as SRO rules. Changes in market structure and the need to remain competitive require constant changes to our systems and order handling procedures. The Company makes these changes while continuously endeavoring to comply with many complex laws and rules. Compliance, surveillance or trading issues, common in the securities industry, and which are monitored or reported to the SEC or SROs, are reviewed in the ordinary course of business by our primary regulators, the SEC and the NASD. The Company, as a major order flow execution destination, is named from time to time in, or is asked to respond to a number of regulatory matters brought by SROs that arise from its trading activity. The Company is currently the subject of various regulatory reviews and investigations. In some instances, these matters may rise to an SEC or SRO disciplinary action and/or civil or administrative action.

For further information on Legal Proceedings, see the section entitled Legal Proceedings , in Part I, Item 3 of our Annual Report on Form 10-K/A for the year ended December 31, 2004.

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Item 2. Changes in Securities and Use of Proceeds

The following table contains information about our purchases of our Class A Common Stock during the third quarter of 2005:

Period[1]	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs [2]	Approximate Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs
July 1, 2005 - July 31, 2005	372,684	$ 8.11	372,500	$ 64,977,676
August 1, 2005 - August 31, 2005	3,604,000	8.23	3,604,000	35,305,111
September 1, 2005 - September 30, 2005	1,350,097	8.54	1,316,000	24,059,900
Total	5,326,781	8.30	5,292,500	

(1) As a matter of policy, the Company does not repurchase its Class A Common Stock during self-imposed closed window periods.

(2) On April 4, 2002, the Company s Board of Directors announced the authorization of a stock repurchase program, which allowed for the purchase of Class A Common Stock up to a total amount of $35 million. This repurchase program was increased by an aggregate of $310 million to a total of $345 million by resolutions of the Company s Board of Directors adopted on July 16, 2002, May 12, 2003, April 20, 2004, August 8, 2004, April 19, 2005 and October 18, 2005, respectively. The Company may repurchase shares in the open market or through privately negotiated transactions, depending on prevailing market conditions, alternative use of capital and other factors. The repurchase program has no set expiration or termination date.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit No.	Exhibit
10.24*	Separation Agreement, effective as of September 6, 2005, between Knight Equity Markets, L.P. and Derek N. Stein. (Incorporated herein by reference to Exhibit 10.1 to Knight s Current Report on Form 8-K (Commission file number 001-14223), dated September 9, 2005).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Management contract or compensatory plan or arrangement.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Jersey City, State of New Jersey, on this 1st day of November, 2005.

KNIGHT CAPITAL GROUP, INC.

By: /s/ THOMAS M. JOYCE

Chairman of the Board and Chief Executive Officer

By: /s/ JOHN B. HOWARD

Chief Financial Officer
(Chief Accounting Officer)