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Broker-Dealer Focus

Freeman & Co. LLC

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Indices at July 29, 2005:

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

Landmark Deals Signal Continued Growth of Electronic Trading Flow

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

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

Summary

Our key findings are:

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

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

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