

JMP Group Inc.  
Form 10-Q  
November 08, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

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(Mark One)

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

For the quarterly period ended September 30, 2007

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: 001-33448

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**JMP Group Inc.**

(Exact name of registrant as specified in its charter)

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Delaware  
(State or Other Jurisdiction of

Incorporation or Organization)

600 Montgomery Street, Suite 1100, San Francisco, California 94111

(Address of principal executive offices)

20-1450327  
(I.R.S. Employer

Identification No.)

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Registrant's telephone number: (415) 835-8900

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The number of shares of the Registrant's common stock, par value \$0.001 per share, outstanding as of October 31, 2007 was 21,961,116.

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**AVAILABLE INFORMATION**

JMP Group Inc. is required to file current, annual and quarterly reports, proxy statements and other information required by the Securities Exchange Act of 1934, as amended (the Exchange Act), with the Securities and Exchange Commission (SEC). You may read and copy any document JMP Group Inc. files with the SEC at the SEC's Public Reference Room located at 100 F Street, N.E., Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an internet website at <http://www.sec.gov>, from which interested persons can electronically access JMP Group Inc.'s SEC filings.

JMP Group Inc. will make available free of charge through its internet site <http://www.jmpg.com>, its annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, Forms 3, 4 and 5 filed by or on behalf of directors, executive officers and certain large stockholders, and any amendments to those documents filed or furnished pursuant to the Exchange Act. These filings will become available as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

JMP Group Inc. also makes available, in the Investor Relations section of its website, (i) its corporate governance guidelines, (ii) its code of business conduct and ethics, and (iii) the charters of the audit, compensation, and corporate governance and nominating committees of its board of directors. These documents, as well as the information on the website of JMP Group Inc., are not a part of this quarterly report.

**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****JMP Group Inc.****Consolidated Statements of Financial Condition****September 30, 2007 and December 31, 2006****(Unaudited)**

|   | <b>September 30, 2007<br/>Successor</b> | <b>December 31, 2006<br/>Predecessor</b> |
|---|---|--|
| <b>Assets</b>   |   |  |
| Cash and cash equivalents   | \$ 95,418,092                           | \$ 52,328,804                            |
| Restricted cash and deposits (includes cash on deposit with clearing broker of \$255,336 at September 30, 2007 and December 31, 2006)           | 10,634,059                              | 8,894,303                                |
| Receivable from clearing broker   | 2,084,956                               | 1,519,623                                |
| Investment banking fees receivable, net of allowance for doubtful accounts of \$65,542 at September 30, 2007 and \$294,905 at December 31, 2006 | 5,260,921                               | 7,962,260                                |
| Marketable securities owned, at market value  | 23,862,441                              | 11,949,187                               |
| Other investments   | 29,149,613                              | 15,244,523                               |
| Loan receivable   | 2,375,000                               |  |
| Fixed assets, net   | 1,997,802                               | 2,625,402                                |
| Deferred tax assets   | 4,422,044                               |  |
| Other assets  | 4,834,593                               | 3,174,901                                |
| <b>Total assets</b>   | <b>\$ 180,039,521</b>                   | <b>\$ 103,699,003</b>                    |
| <b>Liabilities and Shareholders and Members Equity</b>  |   |  |
| <b>Liabilities</b>  |   |  |
| Marketable securities sold, but not yet purchased, at market value  | \$ 9,315,040                            | \$ 7,480,889                             |
| Securities sold under agreements to repurchase  | 9,379,000                               |  |
| Accrued compensation  | 16,602,545                              | 26,446,917                               |
| Other liabilities   | 7,706,446                               | 4,366,157                                |
| Redeemable Class A member interests   |   | 12,913,769                               |
| <b>Total liabilities</b>  | <b>43,003,031</b>                       | <b>51,207,732</b>                        |
| <b>Minority interest</b>  | <b>13,622,402</b>                       | <b>5,739,459</b>                         |
| <b>Commitments and contingencies</b>  |   |  |
| <b>Shareholders and Members Equity</b>  |   |  |
| Class A common interests  |   | 11,861,848                               |
| Class B common interests  |   | 31,650,177                               |
| Common stock, \$0.001 par value, 100,000,000 shares authorized and 22,044,541 outstanding at September 30, 2007                                 | 22,045                                  |  |
| Additional paid-in capital  | 119,481,111                             | 268,635                                  |
| Retained earnings   | 3,910,932                               | 2,971,152                                |
| <b>Total shareholders and members equity</b>  | <b>123,414,088</b>                      | <b>46,751,812</b>                        |

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|   |                |                |
|---|----------------|----------------|
| Total liabilities and shareholders' and members' equity | \$ 180,039,521 | \$ 103,699,003 |
|---|----------------|----------------|

See accompanying notes to consolidated financial statements.

**Table of Contents****JMP Group Inc.****Consolidated Statements of Net Income (Loss)****For the Three and Nine Months Ended****September 30, 2007 and 2006****(Unaudited)**

|   | Nine Months Ended September 30,<br>2007                     |   |   |  |  |
|---|---|---|---|--|--|
|   | Three Months<br>Ended<br>September 30,<br>2007<br>Successor | Three Months<br>Ended<br>September 30,<br>2006<br>Predecessor | January 1, 2007<br>through May 15,<br>2007<br>Predecessor | May 16, 2007<br>through September 30,<br>2007<br>Successor | Nine Months<br>Ended<br>September 30,<br>2006<br>Predecessor |
| <b>Revenues</b>   |   |   |   |  |  |
| Investment banking  | \$ 9,400,830  | \$ 8,805,628  | \$ 16,054,815   | \$ 16,862,878  | \$ 33,543,294  |
| Brokerage   | 8,173,592   | 8,406,327   | 12,986,710  | 12,243,487   | 22,771,641   |
| Asset management fees   | 941,800   | 874,659   | 1,218,467   | 1,502,018  | 2,475,485  |
| Principal transactions  | 854,574   | 1,256,526   | 541,251   | 684,980  | 2,368,879  |
| Interest and dividends  | 1,529,623   | 950,489   | 1,244,663   | 2,222,794  | 2,187,712  |
| Other income  | 107,457   | 162,070   | 326,105   | 147,456  | 324,083  |
| <b>Total revenues</b>   | <b>21,007,876</b>   | <b>20,455,699</b>   | <b>32,372,011</b>   | <b>33,663,613</b>  | <b>63,671,094</b>  |
| <b>Expenses</b>   |   |   |   |  |  |
| Compensation and benefits   | 13,027,380  | 11,662,500  | 18,393,339  | 24,772,727   | 37,627,203   |
| Income allocation and accretion Redeemable Class A member interests     |   | 2,503,956   | 117,418,274   |  | 7,505,245  |
| Administration  | 1,248,940   | 953,437   | 1,770,553   | 2,128,853  | 3,187,297  |
| Brokerage, clearing and exchange fees                                   | 1,289,525   | 1,064,536   | 1,689,174   | 1,896,307  | 2,993,328  |
| Travel and business development   | 621,822   | 967,318   | 1,197,440   | 1,016,178  | 2,760,946  |
| Communications and technology   | 970,488   | 838,693   | 1,389,647   | 1,458,413  | 2,451,691  |
| Occupancy   | 472,758   | 467,645   | 699,774   | 706,035  | 1,381,244  |
| Professional fees   | 551,897   | 340,031   | 375,969   | 1,173,906  | 891,001  |
| Depreciation  | 268,640   | 260,285   | 525,734   | 421,805  | 1,111,248  |
| Interest and dividend expense   | 110,850   | 436,596   | 683,114   | 170,156  | 1,168,912  |
| Other   |   | 9,163   | (241,082)   | 120,904  | 99,761   |
| <b>Total expenses</b>   | <b>18,562,300</b>   | <b>19,504,160</b>   | <b>143,901,936</b>  | <b>33,865,284</b>  | <b>61,177,876</b>  |
| Income (loss) before income tax expense (benefit) and minority interest | 2,445,576   | 951,539   | (111,529,925)   | (201,671)  | 2,493,218  |
| Income tax expense (benefit)  | 1,006,408   |   |   | (4,332,431)  |  |
| Minority interest   | 303,721   | 93,317  | 167,388   | 229,258  | 96,249   |
| <b>Net income (loss)</b>  | <b>\$ 1,135,447</b>   | <b>\$ 858,222</b>   | <b>\$ (111,697,313)</b>                                   | <b>\$ 3,901,502</b>  | <b>\$ 2,396,969</b>  |
| <b>Net income per common share:</b>                                     |   |   |   |  |  |
| Basic   | \$ 0.05   |   |   | \$ 0.18  |  |
| Diluted   | \$ 0.05   |   |   | \$ 0.18  |  |
| Dividends declared and paid per common share                            | \$ 0.025  |   |   | \$ 0.025   |  |
| Weighted average common shares outstanding:                             |   |   |   |  |  |

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|  |            |            |            |
|--|------------|------------|------------|
| Basic  | 22,029,098 |            | 22,027,845 |
| Diluted  | 22,029,098 |            | 22,084,839 |
| Net income (loss) per unit - Class A common interests:         |            |            |            |
| Basic  | \$ 0.23    | \$ (23.84) | \$ 0.64    |
| Diluted  | \$ 0.22    | \$ (23.84) | \$ 0.63    |
| Weighted average units outstanding - Class A common interests: |            |            |            |
| Basic  | 1,435,820  | 2,384,881  | 1,433,444  |
| Diluted  | 1,491,585  | 2,384,881  | 1,452,013  |
| Net income (loss) per unit - Class B common interests:         |            |            |            |
| Basic  | \$ 0.23    | \$ (23.84) | \$ 0.64    |
| Diluted  | \$ 0.22    | \$ (23.84) | \$ 0.63    |
| Weighted average units outstanding - Class B common interests: |            |            |            |
| Basic  | 2,300,000  | 2,300,000  | 2,300,000  |
| Diluted  | 2,389,328  | 2,300,000  | 2,329,795  |

**Pro Forma Statement of Income Information - C-Corp. (Unaudited) (See Note 21)**

|  | <b>January 1, 2007<br/>through May 15,</b> |            |
|--|--|------------|
|  | <b>2007<br/>Predecessor</b>                |            |
| Total revenues   | \$   | 32,372,011 |
| Pro forma total expenses                                 |  | 25,939,081 |
| Pro forma income before income tax and minority interest |  | 6,432,930  |
| Pro forma taxes (42% assumed tax rate)                   |  | 2,701,831  |
| Minority interest  |  | 167,388    |
| Pro forma net income                                     | \$   | 3,563,711  |
| Pro forma net income per common share:                   |  |            |
| Basic  | \$   | 0.24       |
| Diluted  | \$   | 0.24       |
| Pro forma weighted shares of common stock outstanding:   |  |            |
| Basic  |  | 14,800,035 |
| Diluted  |  | 14,905,435 |

See accompanying notes to consolidated financial statements.



**Table of Contents****JMP GROUP INC.****Consolidated Statements of Changes in  
Shareholders and Members Equity****For the Nine Months Ended****September 30, 2007****(Unaudited)**

|   | Class A<br>Common<br>Interests | Class B<br>Common<br>Interests | Members<br>Additional<br>Paid-In<br>Capital | Equity<br>Retained<br>Earnings/<br>(Accumulated<br>Deficit) | Total<br>Equity |
|---|--------------------------------|--------------------------------|---|---|-----------------|
| <b>Predecessor:</b>   |                                |                                |   |   |                 |
| Balance, December 31, 2006  | \$ 11,861,848                  | \$ 31,650,177                  | \$ 268,635                                  | \$ 2,971,152  | \$ 46,751,812   |
| Predecessor activity from January 1, 2007 through<br>May 15, 2007:    |                                |                                |   |   |                 |
| Net loss  |                                |                                |   | (111,697,313)   | (111,697,313)   |
| Additional paid-in capital - stock-based compensation                 |                                |                                | 816,248                                     |   | 816,248         |
| Contributions of Class A common members                               | 401,172                        |                                |   |   | 401,172         |
| Redeemable Class A member interests - liability to equity<br>exchange | 111,209,527                    |                                |   |   | 111,209,527     |
| Distributions paid to Class A and Class B common<br>interests         |                                |                                |   | (6,679,874)   | (6,679,874)     |
| Balance, May 15, 2007 (Predecessor)                                   | \$ 123,472,547                 | \$ 31,650,177                  | \$ 1,084,883                                | \$ (115,406,035)  | \$ 40,801,572   |

|  | Common Stock |           | Shareholders<br>Additional<br>Paid-In | Equity<br>Retained<br>Earnings | Total<br>Equity |
|--|--------------|-----------|---------------------------------------|--------------------------------|-----------------|
|  | Shares       | Amount    | Capital                               |                                |                 |
| <b>Successor:</b>  |              |           |                                       |                                |                 |
| Balance, May 16, 2007  | 1,012,999    | \$ 1,013  | \$ 14,227,555                         | \$ 560,064                     | \$ 14,788,632   |
| Successor activity from May 16, 2007 through<br>September 30, 2007:      |              |           |                                       |                                |                 |
| Net income   |              |           |                                       | 3,901,502                      | 3,901,502       |
| Additional paid-in capital - stock-based compensation                    | 44,642       | 45        | 5,912,608                             |                                | 5,912,653       |
| Issuance of common stock for membership interests                        | 13,787,036   | 13,787    | 26,225,681                            |                                | 26,239,468      |
| Net proceeds from issuance of common stock in initial<br>public offering | 7,199,864    | 7,200     | 73,115,267                            |                                | 73,122,467      |
| Cash dividends paid to shareholders                                      |              |           |                                       | (550,634)                      | (550,634)       |
| Balance, September 30, 2007 (Successor)                                  | 22,044,541   | \$ 22,045 | \$ 119,481,111                        | \$ 3,910,932                   | \$ 123,414,088  |

See accompanying notes to consolidated financial statements.



**Table of Contents****JMP Group Inc.****Consolidated Statements of Cash Flows****For the Nine Months Ended****September 30, 2007 and 2006****(Unaudited)**

|  | Nine Months Ended September 30, 2007                      |  | Nine Months Ended September 30, 2006<br>Predecessor |
|--|---|--|---|
|  | January 1, 2007<br>through May 15,<br>2007<br>Predecessor | May 16, 2007<br>through September 30,<br>2007<br>Successor |   |
| Cash flows from operating activities:  |   |  |   |
| Net (loss) income  | \$ (111,697,313)  | \$ 3,901,502   | \$ 2,396,969  |
| Adjustments to reconcile net (loss) income to net cash used in operating activities:       |   |  |   |
| Change in provision for doubtful accounts  | (241,079)   | 20,906   | 99,761  |
| Change in fair value of other investments  | (657,130)   | (681,924)  | (2,043,634)   |
| Depreciation and amortization of fixed assets  | 525,734   | 421,805  | 1,111,248   |
| Write-off of fixed assets  |   |  | 132,359   |
| Minority interest  | 167,388   | 229,258  | 96,249  |
| Dividends declared to minority interest shareholders in the form of participation interest |   | (1,197,238)  |   |
| Stock-based compensation expense   | 816,249   | 5,912,653  | 74,605  |
| Deferred tax assets  |   | (4,179,112)  |   |
| Net change in operating assets and liabilities:  |   |  |   |
| Decrease (increase) in receivables   | 1,421,098   | 1,780,465  | (43,985)  |
| Increase in marketable securities  | (3,953,001)   | (7,960,252)  | (5,111,792)   |
| Decrease in restricted cash, deposits and other assets                                     | (1,271,797)   | (3,086,775)  | (2,888,411)   |
| Increase in marketable securities sold, but not yet purchased                              | 1,561,160   | 272,991  | 5,497,501   |
| Increase in securities sold under agreements to repurchase                                 |   | 9,379,000  |   |
| (Decrease) increase in accrued compensation and other liabilities                          | (15,189,481)  | 8,742,204  | (8,072,199)   |
| Increase (decrease) in Redeemable Class A member interests                                 | 98,696,930  |  | (1,580,030)   |
| Net cash (used in) provided by operating activities  | (29,821,242)  | 13,555,483   | (10,331,359)  |
| Cash flows from investing activities:  |   |  |   |
| Purchases of fixed assets  | (60,416)  | (259,521)  | (223,555)   |
| Purchases of other investments   | (700,000)   | (12,288,858)   | (1,290,558)   |
| Sales of other investments   | 251,696   | 171,120  | 4,167,583   |
| Funding of loan receivable   |   | (3,000,000)  | (3,000,000)   |
| Repayment of loan receivable   |   | 625,000  | 3,000,000   |
| Net cash (used in) provided by investing activities  | (508,720)   | (14,752,259)   | 2,653,470   |
| Cash flows from financing activities:  |   |  |   |
| Increase (decrease) in notes payable   | 14,500,000  | (14,500,000)   |   |
| Proceeds from initial public offering, net of expenses                                     |   | 73,122,467   |   |
| Distributions paid to Class A and Class B common interests                                 | (6,679,874)   |  | (3,058,995)   |
| Capital contributions of minority interest shareholders                                    | 200,000   | 8,488,014  | 2,002,000   |
| Cash dividends paid to shareholders  |   | (550,634)  |   |
| Dividends paid to minority interest shareholders   |   | (25,280)   |   |
| Net cash provided by (used in) financing activities  | 8,020,126   | 66,534,567   | (1,056,995)   |
| Net (decrease) increase in cash and cash equivalents                                       | (22,309,836)  | 65,337,791   | (8,734,884)   |

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|   |               |               |               |
|---|---------------|---------------|---------------|
| Cash and cash equivalents, beginning of period            | 52,328,804    | 30,080,301    | 61,724,672    |
| Cash and cash equivalents, end of period                  | \$ 30,018,968 | \$ 95,418,092 | \$ 52,989,788 |
| <b>Supplemental disclosures of cash flow information:</b> |               |               |               |
| Cash paid during the period for interest                  | \$ 1,033,937  | \$ 53,126     | \$ 1,355,722  |
| Cash paid during the period for taxes                     | \$            | \$ 234,337    | \$            |
| <b>Non-cash financing activities:</b>                     |               |               |               |
| Issuance of Class A common interests                      | \$ 401,172    | \$            | \$            |
| Issuance of JMPRT common stock                            | \$ 20,800     | \$            | \$            |

See accompanying notes to consolidated financial statements

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**JMP GROUP INC.**

**Notes to Consolidated Financial Statements**

**September 30, 2007**

**(Unaudited)**

**1. Organization and Description of Business**

JMP Group Inc., together with its subsidiaries (collectively, the Company or Successor ), is an independent investment banking and asset management firm headquartered in San Francisco. The Company conducts its brokerage business through its wholly-owned subsidiary, JMP Securities LLC ( JMP Securities ), and its asset management business through its wholly-owned subsidiary, JMP Asset Management LLC ( JMPAM ). JMP Securities is a U.S. registered broker-dealer under the Securities Exchange Act of 1934 and is a member of the Financial Industry Regulatory Authority. JMP Securities operates as an introducing broker and does not hold funds or securities for, or owe any money or securities to, customers and does not carry accounts for customers. All customer transactions are cleared through another broker-dealer on a fully disclosed basis. JMPAM is a registered investment advisor under the Investment Advisers Act of 1940 and provides investment management services for sophisticated investors in investment partnerships managed by JMPAM.

Prior to May 16, 2007 the Company had conducted its business through a multi-member Delaware limited liability company, JMP Group LLC (the Predecessor ), pursuant to its Third Amended and Restated Limited Liability Company Operating Agreement dated as of August 18, 2004, as amended (the Operating Agreement ). One of JMP Group LLC 's members, JMP Holdings Inc. ( JMP Holdings ), was established in August 2004 to enable investors to invest through a corporate entity in the membership interests of JMP Group LLC. Shares of common stock of JMP Holdings were issued in a private offering in August 2004. JMP Holdings ' only significant asset until May 16, 2007 was its investment in JMP Group LLC, comprised of the member interests of JMP Group LLC, which had been purchased with the net proceeds received from issuance of JMP Holdings ' common stock.

In connection with its initial public offering, JMP Holdings changed its name to JMP Group Inc., and effective May 16, 2007 (the Reorganization Date ), members of JMP Group LLC exchanged the outstanding membership interests of JMP Group LLC for shares of common stock of JMP Group Inc. As a result of the exchange, JMP Group LLC became JMP Group Inc. 's wholly-owned subsidiary, and JMP Group Inc. completed its initial public offering on May 16, 2007. This reorganization (the Reorganization ) is described in greater detail in the Registration Statement on Form S-1 (File No. 333-140689) (the Registration Statement ) filed with the Securities and Exchange Commission ( SEC ) in connection with the initial public offering.

**2. Summary of Significant Accounting Policies**

*Basis of Presentation*

These consolidated financial statements and related notes are unaudited and have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. These consolidated financial statements should be read in conjunction with the Company 's consolidated financial statements and notes thereto for the year ended December 31, 2006 included in its Registration Statement on Form S-1 filed with the SEC (File No. 333-140689). These consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for the fair statement of the results for the interim periods. The results of operations for any interim period are not necessarily indicative of the results to be expected for a full year.

These financial statements and accompanying notes present the consolidated financial condition of the Successor as of September 30, 2007, and of the Predecessor as of December 31, 2006. Consolidated results of operations and cash flows are presented for the Predecessor for the three and nine months ended September 30, 2006 and the period from January 1, 2007 through May 15, 2007 (pre-Reorganization), and for the Successor for the three months ended September 30, 2007 and for the period from May 16, 2007 through September 30, 2007 (post-Reorganization). The Reorganization resulted in a business combination of the Predecessor (JMP Group LLC) and JMP Holdings (now JMP Group Inc.), whose financial statements had not been combined with those of the

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Predecessor prior to May 16, 2007 for reporting purposes. Therefore, the Successor's consolidated financial statements as of May 16, 2007 include the accounts of both JMP Group LLC and JMP Group Inc. The consolidated accounts of the Successor and the Predecessor both include the wholly-owned subsidiaries, JMP Securities and JMPAM, and the partially-owned subsidiaries, JMP Realty Trust ( JMPRT ), Harvest Consumer Partners ( HCP ) and Harvest Technology Partners ( HTP ). All material intercompany accounts and transactions have been eliminated in consolidation.

Minority interest relates to the interest of third parties in JMPRT and in the two asset management funds HCP and HTP.

JMPRT is a real estate investment trust that was formed in June 2006. As of September 30, 2007, the Company owned 49.6% of JMPRT and certain employees owned 20.1%. JMPRT is managed by JMPAM. Because of the current ownership and management position, the Company consolidates JMPRT and records minority interest.

JMPAM is the general partner of HTP and HCP, each of which commenced operations during 2006. As of September 30, 2007, the Company and its affiliates, officers, and immediate family members provided 96.8% and 95.0%, respectively, of the invested capital in these funds. Due to this ownership and resulting control by the Company and related parties, the Company consolidates the two funds in the Company's financial statements and records minority interest. HTP and HCP account for their investments at fair value, which is consistent with the Company's accounting policies for Marketable securities owned, at market value and Marketable securities sold, but not yet purchased, at market value. The base management fees and incentive fees earned by HTP and HCP are eliminated in consolidation.

### *Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions that affect both the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results may differ from those estimates.

### *Revenue Recognition*

#### *Investment banking revenues*

Investment banking revenues consist of underwriting revenues, strategic advisory revenues and private placement fees, and are recorded when the underlying transaction is completed under the terms of the relevant agreement. Underwriting revenues arise from securities offerings in which the Company acts as an underwriter and include management fees, selling concessions and underwriting fees, net of related syndicate expenses. Management fees and selling concessions are recorded on the trade date, which is typically the day of pricing an offering (or the following day) and underwriting fees, net of related syndicate expenses, at the time the underwriting is completed and the related income is reasonably determinable. For these transactions, management estimates the Company's share of the transaction-related expenses incurred by the syndicate, and recognizes revenues net of such expense. On final settlement, typically 90 days from the trade date of the transaction, these amounts are adjusted to reflect the actual transaction-related expenses and the resulting underwriting fee. Expenses associated with such transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded. If management determines that a transaction is likely not to be completed, deferred expenses related to that transaction are expensed at that time. Strategic advisory revenues primarily include success fees on closed merger and acquisition transactions, as well as retainer fees, earned in connection with advising on both buyers' and sellers' transactions. Fees are also earned for related advisory work and other services such as providing fairness opinions and valuation analyses. Strategic advisory revenues are recorded when the transactions or the services (or, if applicable, separate components thereof) to be performed are substantially complete, the fees are determinable and collection is reasonably assured. Private placement fees are recorded on the closing date of the transaction. Unreimbursed expenses associated with strategic advisory and private placement transactions, net of client reimbursements, are recorded as non-compensation expense.

#### *Brokerage revenues*

Brokerage revenues consist of (i) commissions resulting from equity securities transactions executed as agent or principal and are recorded on a trade date basis, (ii) related net trading gains and losses from market making activities and from the commitment of capital to facilitate customer orders and (iii) fees paid for equity research. The Company currently generates revenues from research activities through three types of arrangements. First, through what is commonly known as a "soft dollar" practice, a portion of a client's commissions may be compensation for the value of access to our research. Those



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commissions are recognized on a trade date basis, as the Company has no further obligation. Second, a client may issue a cash payment directly to the Company for access to research. Third, the Company has entered into certain commission-sharing or tri-party arrangements in which institutional clients execute trades with a limited number of brokers and instruct those brokers to allocate a portion of the commission to the Company or to issue a cash payment to the Company. In these commission-sharing or tri-party arrangements, the amount of the fee is determined by the client on a case-by-case basis and agreed to by the Company. An invoice is then sent to the payor. For the second and third types of arrangements, revenue is recognized and an invoice is sent once an arrangement exists, access to research has been provided, a specific amount is fixed or determinable, and collectibility is reasonably assured. None of these arrangements obligate clients to a fixed amount of fees for research, either through trading commissions or direct or indirect cash payments, nor do they obligate the Company to provide a fixed quantity of research or execute a fixed number of trades. Furthermore, the Company is not obligated under any arrangement to make commission payments to third parties on behalf of clients.

*Principal transactions revenues*

Principal transactions revenues include realized and unrealized net gains and losses resulting from our principal investments in equity securities for the Company's account and in equity-linked warrants received from certain investment banking assignments. Principal transactions revenue also includes earnings (or losses) attributable to investment partnership interests held by our asset management subsidiary, JMPAM, which are accounted for using the equity method of accounting.

The Company's principal transactions revenue for these categories for the three and nine month periods ended September 30, 2007 and 2006 are as follows:

|                                       | Nine Months Ended September 30,<br>2007        |  |  |   |   |
|---------------------------------------|--|--|--|---|---|
|                                       | Three Months<br>Ended<br>September 30,<br>2007 | Three Months<br>Ended<br>September 30,<br>2006 | January 1, 2007<br>through May 15,<br>2007 | May 16, 2007<br>through September 30,<br>2007 | Nine Months<br>Ended<br>September 30,<br>2006 |
|                                       | Successor                                      | Predecessor                                    | Predecessor                                | Successor                                     | Predecessor                                   |
| Equity and other securities           | \$ 303,873                                     | \$ 817,817                                     | \$ (135,301)                               | \$ 8,310                                      | \$ 1,236,090                                  |
| Warrants                              | 119,035  | (84,231)                                       | 11,904                                     | 78,769  | (237,969)                                     |
| Investment partnerships               | 431,666  | 522,940  | 664,648                                    | 597,901                                       | 1,370,758                                     |
| Total principal transactions revenues | \$ 854,574                                     | \$ 1,256,526                                   | \$ 541,251                                 | \$ 684,980                                    | \$ 2,368,879                                  |

*Asset management fees*

Asset management fees consist of base management fees and incentive fees. The Company recognizes base management fees on a monthly basis over the period in which the investment services are performed. Base management fees earned by the Company are generally based on the fair value of assets under management and the fee schedule for each fund and account. Base management fees are calculated at the investor level using their quarter-beginning capital balance adjusted for any contributions or withdrawals. Since base management fees are based on assets under management, significant changes in the fair value of these assets will have an impact on the fees earned by the Company in future periods. The Company also earns incentive fees that are based upon the performance of investment funds and accounts. Such fees are either a specified percentage of the total investment return of a fund or account or a percentage of the excess of an investment return over a specified highwater mark or hurdle rate over a defined performance period. For most funds, the highwater mark is calculated using the greatest value of a partner's capital account as of the end of any performance period, adjusted for contributions and withdrawals. Incentive fees are recognized as revenue at the end of the specified performance period. The performance period used to determine the incentive fee is quarterly for the five hedge funds and annually for the two funds of hedge funds managed by JMPAM. The incentive fees are not subject to any contingent repayments to investors or any other clawback arrangements.

*Cash and Cash Equivalents*

The Company considers highly liquid investments with original maturities or remaining maturities upon purchase of three months or less to be cash equivalents.

*Restricted Cash and Deposits*



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Restricted cash consists of proceeds from short sales deposited with brokers that cannot be removed unless the securities are delivered. Deposits consist of cash on deposit for operating leases as well as cash on deposit with JMP Securities clearing broker.

### *Receivable from Clearing Broker*

The Company clears customer transactions through another broker-dealer on a fully disclosed basis. At September 30, 2007 and December 31, 2006, the receivable from clearing broker consisted solely of commissions related to securities transactions.

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### *Investment Banking Fees Receivable*

Investment banking fees receivable include receivables relating to the Company's investment banking or advisory engagements. The Company records an allowance for doubtful accounts on these receivables on a specific identification basis.

### *Securities Sold Under Repurchase Agreements*

Securities sold under repurchase agreements are accounted for as collateralized financing transactions. The liabilities that result from these agreements are recorded in the consolidated statements of financial condition at the amounts at which the securities were sold. The Company pledged owned quasi-government agency securities as collateral, which is valued daily, and the Company may be required to deposit additional collateral. Interest expense is recorded on an accrual basis and is recorded in the Consolidated Statements of Net Income (Loss).

### *Securities and Other Investments*

Marketable securities owned and securities sold, but not yet purchased, consist of equity securities and quasi-government agency securities. These securities are carried at market value, which is based on quoted market prices, with unrealized gains and losses included in revenues as principal transactions. Such amounts are determined on a trade date basis.

Other investments consist principally of investments in private investment funds managed by the Company or its affiliates, as well as cash paid for a subscription in a private investment fund. Such investments held by non-broker-dealer entities are accounted for under the equity method based on the Company's share of the earnings (or losses) of the investee. The financial position and operating results of the private investment funds are generally determined on an estimated fair value basis as set forth in the AICPA Audit and Accounting Guide: *Investment Companies*. Generally, securities are valued (i) at their last published sale price if they are listed on an established exchange or (ii) if last sales prices are not published, at the highest closing bid price (for securities held long) and the lowest closing asked price (for short positions) as recorded by the composite tape system or such principal exchange, as the case may be. Where the general partner determines that market prices or quotations do not fairly represent the value of a security in the investment fund's portfolio (for example, if a security is a restricted security of a class that is publicly traded) the general partner may assign a different value. The general partner will determine the estimated fair value of any assets that are not publicly traded.

Also included in other investments are warrants on public common stock that are generally received as a result of investment banking transactions and are valued at estimated fair value as determined by management. Warrants owned are valued at the date of issuance and marked-to-market as unrealized gains and losses until realized. Estimated fair value is determined using the Black-Scholes Option Valuation methodology adjusted for active market and other considerations on a case-by-case basis. Initial value and gains and losses on these investments are included in revenues as principal transactions. Because of the inherent uncertainty of valuations of warrants, estimated fair values may differ significantly from the value that would have been used had a ready market for the investments existed, and these differences could be material.

### *Fair Value of Financial Instruments*

Substantially all of the Company's financial instruments are recorded at fair value or contractual amounts that approximate fair value. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidating sale. Securities owned, other investments and securities sold, not yet purchased, are stated at fair value, with related changes in unrealized appreciation or depreciation reflected in the accompanying Consolidated Statements of Net Income (Loss).

Management believes that the net fair value of the receivable from clearing broker, investment banking fees receivable, and accrued compensation recognized on the Consolidated Statements of Financial Condition approximate their carrying value, because such instruments are short-term in nature, bear interest at current market rates, or are subject to frequent repricing. The fair value of the Redeemable Class A member interests recognized on the Predecessor's Consolidated Statements of Financial Condition was based on the amounts that the Predecessor expected to be required to pay to an employee member upon resignation to redeem its Redeemable Class A member interests and was equal to the capital account of such employee member as maintained by the Predecessor.

Fair value of the Company's financial instruments is generally obtained from quoted market prices, broker or dealer price quotations, or alternative pricing methodologies that the Company believes offer reasonable levels of price transparency.

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To the extent that certain financial instruments trade infrequently or are non-marketable securities and, therefore, do not have readily determinable fair values, the Company estimates the fair value of these instruments using various pricing models and the information available to the Company that it deems most relevant. Among the factors considered by the Company in determining the fair value of financial instruments are discounted anticipated cash flows, the cost, terms and liquidity of the instrument, the financial condition, operating results and credit ratings of the issuer or underlying company, the quoted market price of publicly traded securities with similar duration and yield, the Black-Scholes Option Valuation methodology adjusted for active market and other considerations on a case-by-case basis and other factors generally pertinent to the valuation of financial instruments.

### *Loan Receivable*

Loan receivable consists of a loan made by JMPRT to a client as part of its normal business operations. The loan is collateralized by real estate related assets, and bears interest at the rate of 20% per annum, payable monthly in arrears. The principal of the loan is due and payable on December 1, 2007, but can be extended for six months at the borrower's option for an additional fee. On September 25, 2007, the board of directors of JMPRT declared a distribution payable to its shareholders in the form of participation interests in the fair market value of the loan receivable. The distribution was made in October 2007.

### *Fixed Assets*

Fixed assets represent furniture and fixtures, computer and office equipment, certain software costs and leasehold improvements, which are stated at cost less accumulated depreciation and amortization. Depreciation is computed on the straight-line basis over the estimated useful lives of the respective assets, ranging from three to five years.

Leasehold improvements are capitalized and amortized over the shorter of the respective lease terms or the estimated useful lives of the improvements.

The Company capitalizes certain costs of computer software developed or obtained for internal use and amortizes the amount over the estimated useful life of the software, generally not exceeding three years.

### *Income Taxes*

The Successor, JMP Group Inc., accounts for income taxes in accordance with Statement of Financial Standards No. 109, *Accounting for Income Taxes*, ( SFAS 109 ). SFAS 109 requires the recognition of deferred tax assets and liabilities based upon temporary differences between the financial reporting and tax bases of its assets and liabilities. Valuation allowances are established when necessary to reduce deferred tax assets when it is more likely than not that a portion or all of the deferred tax assets will not be realized. The Predecessor, JMP Group LLC, was a limited liability company and was treated as a partnership for federal and state income tax purposes. Therefore, the Predecessor was not subject to federal and state income taxes, and accordingly, did not provide for the federal and state income taxes in the financial statements, but it was liable for state and local unincorporated business tax or franchise tax.

### *Stock-Based Compensation*

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123(R) ( SFAS 123R ), *Share-Based Payment*, using the modified prospective method. Under that method of adoption, the provisions of SFAS 123R are generally only applied to share-based awards granted subsequent to adoption. Prior to January 1, 2006, the Company accounted for stock-based compensation under SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS 123R requires measurement of compensation cost for stock-based awards classified as equity at their fair value on the date of grant and the recognition of compensation expense over the service period for awards expected to vest. Such grants are recognized as expense over the service period, net of estimated forfeitures.

Stock-based compensation includes restricted stock units and stock options granted under the Company's 2007 Equity Incentive Plan, stock options granted under the Company's 2004 Equity Incentive Plan, as well as changes in Redeemable Class A member interests, which were membership interests issued to the Predecessor's employee members and recorded as a liability prior to May 16, 2007. On May 16, 2007, in connection with the Reorganization, the Redeemable Class A member interests were exchanged for shares of the Company's common stock and reclassified as equity.

In accordance with generally accepted valuation practices for stock-based awards issued as compensation, the Company uses the Black-Scholes option-pricing model to calculate the fair value of all stock-based awards, although such models were originally developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock options and

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restricted stock units. The Black-Scholes model requires subjective assumptions regarding variables such as future stock price volatility, dividend yield and expected time to exercise, which greatly affect the calculated values.

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Certain balances from prior years have been reclassified in order to conform to the current year presentation. The reclassifications had no impact on the Company's financial position, net income (loss) or cash flows.

**3. Recent Accounting Pronouncements**

SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ) In September 2006, the Financial Accounting Standards Board ( FASB ) issued SFAS 157, which will become effective for the Company on January 1, 2008. This standard establishes a consistent framework for measuring fair value in accordance with generally accepted accounting principles ( GAAP ) and expands disclosures with respect to fair value measurements. The Company is assessing SFAS 157 to determine the financial impact, if any, on the Company's consolidated financial statements.

Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* ( FIN 48 ) In June 2006, the FASB issued FIN 48, which prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken on a tax return and provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted FIN 48 on May 16, 2007, the date the Company became subject to federal and state income taxes. Its adoption did not have a material impact on the Company's financial condition or results of operations.

SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an Amendment of FASB Statement No. 115* ( SFAS 159 ) In February 2007, the FASB issued SFAS 159, which provides companies with an option to report selected financial assets and liabilities at fair value. It requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. In addition, unrealized gains and losses on items for which the fair value option has been elected are reported in earnings. SFAS 159 is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating SFAS 159 and has not yet determined the financial assets and liabilities, if any, for which the fair value option would be elected or the potential impact on the results of operations or financial condition if such election were made.

**4. Securities and Other Investments**

Marketable securities owned consist primarily of U.S. listed and over-the-counter equities and quasi-government agency securities, all of which are carried at market value. Marketable securities sold, but not yet purchased, represent obligations of the Company to deliver a specific security at a contracted price and thereby create a liability to repurchase the security in the market at prevailing prices. Accordingly, these transactions involve, to varying degrees, elements of market risk, as the Company's ultimate obligation to satisfy the sale of securities sold, but not yet purchased, may exceed the amount currently recognized in the Consolidated Statements of Financial Condition.

The cost and market values of marketable securities owned and proceeds of securities sold, but not yet purchased are as follows at September 30, 2007 and December 31, 2006:

|  | September 30, 2007   |                      |                      |                     | December 31, 2006    |                     |                      |                     |
|--|----------------------|----------------------|----------------------|---------------------|----------------------|---------------------|----------------------|---------------------|
|  | Cost                 |                      | Market               |                     | Cost                 |                     | Market               |                     |
|  | Sold, But            |                      | Sold, But            |                     | Sold, But            |                     | Sold, But            |                     |
|  | Owned                | Not Yet Purchased    | Owned                | Not Yet Purchased   | Owned                | Not Yet Purchased   | Owned                | Not Yet Purchased   |
| Equity securities  | \$ 13,079,892        | \$ 10,123,142        | \$ 14,189,769        | \$ 9,315,040        | \$ 11,592,593        | \$ 7,193,997        | \$ 11,949,187        | \$ 7,480,889        |
| Quasi-government agency securities                                       | 9,672,672            |                      | 9,672,672            |                     |                      |                     |                      |                     |
| <b>Total securities owned and securities sold, but not yet purchased</b> | <b>\$ 22,752,564</b> | <b>\$ 10,123,142</b> | <b>\$ 23,862,441</b> | <b>\$ 9,315,040</b> | <b>\$ 11,592,593</b> | <b>\$ 7,193,997</b> | <b>\$ 11,949,187</b> | <b>\$ 7,480,889</b> |

Included in other investments are investments in partnerships in which one of the Company's subsidiaries is the investment manager and general partner. The Company accounts for these investments using the equity method as described in Note 2. The Company's proportionate share of

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those investments is included in the table below. In addition, other investments include warrants, and two investments in funds managed by third parties.

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The carrying values of other investments are as follows at September 30, 2007 and December 31, 2006:

|  | September 30,<br>2007 | December 31,<br>2006 |
|--|-----------------------|----------------------|
| General Partner in Hedge Funds         | \$ 22,181,774         | \$ 11,785,581        |
| General Partner in Fund of Funds       | 4,250,483             | 583,143              |
| Total of General Partner in Funds      | 26,432,257            | 12,368,724           |
| Limited Partner in Private Equity Fund | 2,338,157             | 2,384,074            |
| Warrants                               | 379,199               | 491,725              |
| Total                                  | \$ 29,149,613         | \$ 15,244,523        |

**5. Fixed Assets**

At September 30, 2007 and December 31, 2006, fixed assets consisted of the following:

|                                | September 30, 2007<br>Successor | December 31, 2006<br>Predecessor |
|--------------------------------|---------------------------------|----------------------------------|
| Furniture and fixtures         | \$ 1,302,611                    | \$ 1,247,728                     |
| Computer and office equipment  | 2,939,931                       | 2,664,425                        |
| Leasehold improvements         | 2,288,090                       | 2,268,978                        |
| Software                       | 451,590                         | 438,931                          |
| Less: accumulated depreciation | (4,984,420)                     | (3,994,660)                      |
| Total fixed assets, net        | \$ 1,997,802                    | \$ 2,625,402                     |

Depreciation expense for the quarter ended September 30, 2007 was \$268,640 and \$260,285 for the quarter ended September 30, 2006. Depreciation expense for the nine months ended September 30, 2007 was \$525,734 for the period of January 1, 2007 through May 15, 2007, \$421,805 for the period of May 16, 2007 through September 30, 2007, and \$1,111,248 for the nine months ended September 30, 2006.

**6. Note Payable**

On August 3, 2006, the Predecessor entered into a revolving note with City National Bank for up to \$30.0 million, replacing a prior \$10.0 million annual revolving note. Each draw bears interest at the prime rate less 1.25% annually or at LIBOR plus 1.25% annually, at the election of the Company, and the note expires on June 30, 2008. The Company paid a closing fee of \$75,000 and pays an annual unused commitment fee of 0.25% payable quarterly in arrears. The Company has the option to extend the term of the revolving note by one year or to convert the outstanding balance to a three-year term loan. There are no periodic principal payments required for this facility until maturity. This facility is collateralized by a pledge of the Company's assets, including its interests in each of JMP Securities and JMPAM. There was no outstanding note balance at September 30, 2007.

**7. Redeemable Class A Member Interests**

Redeemable Class A member interests were issued to employees of the Predecessor or its subsidiaries, and were entitled to share in the operating profits of the Predecessor. Redeemable Class A member interests were identical in nature to Class A common interests issued to non-employee Class A common members, except that Class A common members were not subject to insider rules, as defined in the Operating Agreement. These insider rules provided, among other items, that the Predecessor could redeem the employee member's interest in the Predecessor at any time, in whole or in part. In addition, the employee member could redeem his or her Redeemable Class A member interests in whole upon his or her resignation from providing services to the Predecessor. In either such case (and excluding terminations for cause or upon events of default), the redemption price would be either of the following at the Predecessor's election: (i) the capital account balance of the employee member or (ii) the percent of liquidation value represented by such interest based on a valuation formula. Redeemable Class A member interests and

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Class A common interests combined represented a fixed percentage equal to 84.5% of the Predecessor's membership interests. Increases and decreases in Redeemable Class A member interests resulted in offsetting decreases and increases in Class A common interests. As a result, Redeemable Class A member interests represented a variable percentage of the Predecessor's total membership interests. Redeemable Class A member interests represented 68.3% and 74.8% of the Predecessor's membership interests as of May 15, 2007 and December 31, 2006, respectively.



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Redeemable Class A member interests were accounted for as stock-based compensation under SFAS 123 until December 31, 2005 and under SFAS 123R thereafter. Each holder of Redeemable Class A member interests was a party to the Operating Agreement, which provided that an employee member could elect to redeem all, but not less than all, of their Redeemable Class A member interests without the Predecessor's consent in connection with such person's resignation from the Predecessor. Because the redemption feature permitted the employee to avoid bearing the risks and rewards normally associated with equity share ownership for a reasonable period of time and gave the Predecessor no discretion to avoid transferring its cash or assets to the employee if the employee elected redemption, the Redeemable Class A member interests were classified as a liability by the Predecessor. The liability amount for the Redeemable Class A member interests was measured at each balance sheet date based on the redemption amounts for the Class A member interests. The redemption amount for an employee member was the amount the Predecessor was required to pay to an employee member upon resignation to redeem all his Redeemable Class A member interests as provided by the Operating Agreement. Management determined that member interests would be redeemed at an amount equal to the capital account of such employee member as maintained by the Predecessor. The pro rata share of the Predecessor's income allocated to Redeemable Class A member interests and any additional changes in the redemption amount of Redeemable Class A member interests were recorded as Income allocation and accretion Redeemable Class A member interests in the Predecessor's Consolidated Statements of Net Income (Loss).

The following table summarizes the activity for the Redeemable Class A member interests for the period from January 1, through May 15, 2007 and for the year ended December 31, 2006:

|                                 |               |
|---------------------------------|---------------|
| Balance, December 31, 2005      | \$ 11,516,753 |
| Contributions                   | 4,643,527     |
| Redemptions                     | (2,508,681)   |
| Income allocation and accretion | 10,663,934    |
| Distributions                   | (11,401,764)  |
| <br>                            |               |
| Balance, December 31, 2006      | 12,913,769    |
| Contributions                   | 2,375,442     |
| Redemptions                     | (3,479,800)   |
| Income allocation and accretion | 117,418,274   |
| Distributions                   | (18,018,158)  |
| Liability to equity exchange    | (111,209,527) |
| <br>                            |               |
| Balance, May 15, 2007           | \$            |

In connection with the Reorganization, the Redeemable Class A member interests were exchanged for shares of the Company's common stock and reclassified from liability to equity. The liability-to-equity exchange of the Redeemable Class A member interests required the Predecessor to mark the liability for the Redeemable Class A member interests to its fair market value and to record a non-cash expense related to the change in value. The Predecessor accounted for the exchange in its consolidated financial statements as follows:

The Predecessor recorded a one-time non-cash expense as a component of Income allocation and accretion Redeemable Class A member interests equal to \$112.9 million, which represented the difference between (a) the equity amount recorded for the shares of common stock issued in exchange for the Redeemable Class A member interests and (b) the carrying amount of the Redeemable Class A member interests prior to the Reorganization; and then

The Predecessor recorded additional equity equal to \$111.2 million for the 10,109,957 shares of common stock exchanged for the Redeemable Class A member interests based on the initial public offering price of \$11.00 per share.

**8. Shareholders and Members Equity***Membership Classes and Capital Accounts Prior to the Reorganization*

A capital account was maintained for each member of JMP Group LLC until the Reorganization on May 16, 2007. The account was increased by capital contributions, allocable share of net profit and any items of income or gain and decreased by distributions, allocable share of net loss

and any items of expense or loss.

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### *Class A Common Interests*

Class A common interests were issued to non-employee members, some of whom converted their Series A Convertible Preferred Units into Class A common interests in April 2004, and were entitled to share in the operating profits of the Predecessor. Class A common interests and Redeemable Class A member interests combined represented a fixed percentage equal to 84.5% of the Predecessor's membership interests. Increases and decreases in Class A common interests resulted in offsetting decreases and increases in Redeemable Class A member interests. As a result, Class A common interests represented a variable percentage of the Predecessor's total membership interests. Class A common interests represented 16.2% and 9.7% of the Predecessor's membership interests as of May 15, 2007 and December 31, 2006, respectively.

### *Class B Common Interests*

On August 18, 2004, the Predecessor issued Class B common interests in a private offering to qualified institutional buyers and accredited investors. The Class B common interests outstanding were equal to 15.5% of the total outstanding membership interests of the Predecessor at the closing of the private offering. Class B common interests were identical in nature to Class A common interests, except for: (i) the anti-dilution provision, which provided that the Class B membership interests would not be reduced by additional issuances of Class A common interests or Redeemable Class A member interests, and (ii) demand registration rights which gave the holders of Class B common interests an annual vote to cause a corporate conversion of the Predecessor, which would have resulted in registration of the converted common interests with the SEC with subsequent listing on a national exchange or the over-the-counter market. Class B common interests represented 15.5% of the Predecessor's membership interests as of May 15, 2007 and December 31, 2006.

### *Common Stock*

Shares of JMP Holdings Inc. common stock were originally sold in a private offering in August 2004 to enable certain non-employee investors to invest through a corporate entity in the membership interests of JMP Group LLC. JMP Holdings in turn owned, as a member of JMP Group LLC, Class B common interests on a one-for-one basis for each share of common stock. The number of common shares of JMP Holdings issued and outstanding was 1,012,999 as of May 15, 2007 and December 31, 2006. Effective May 16, 2007, in connection with the Company's initial public offering, the members of JMP Group LLC exchanged the outstanding membership interests of JMP Group LLC for shares of common stock of JMP Holdings, and JMP Holdings changed its name to JMP Group Inc. In the initial public offering, the Company sold and issued 7,199,864 shares of its common stock, raising \$73.1 million of proceeds, net of the Company's direct offering costs.

The Company intends to declare quarterly cash dividends on all outstanding shares of common stock. We do not plan to pay dividends on unvested shares of restricted stock.

On August 7, 2007, the Company's board of directors declared a cash dividend of \$0.025 per share of common stock for the second quarter of 2007 which was paid on August 30, 2007 to common shareholders of record on August 23, 2007. This amount represents a prorated quarterly dividend for the period from the Company's initial public offering on May 16, 2007 through June 30, 2007, based upon a quarterly dividend rate of \$0.05 per share.

### *Stock Repurchase Program*

On August 7, 2007, the Company's board of directors authorized the repurchase of up to one million shares of the Company's outstanding common stock during the next twelve months. The approval of this program authorizes, but does not commit, the Company to repurchase shares of its common stock. Repurchases may be made in open market or private transactions. The repurchase program is, among other things, intended to reduce the dilutive effect of the Company's equity compensation programs.

The timing and amount of any repurchases will be determined by JMP management based on its evaluation of market conditions, the relative attractiveness of other capital deployment activities, regulatory considerations and other factors. Any open market stock repurchase activities will be conducted in compliance with the safe harbor provisions of Rule 10b-18 of the Securities Exchange Act of 1934, as amended, or in privately negotiated transactions. Repurchases of common stock may also be made under a Rule 10b5-1 plan which the Company entered into in September 2007 and which would permit common stock to be repurchased pursuant to a predetermined formula when the Company may otherwise be prohibited from doing so under insider trading laws. This repurchase program may be suspended or discontinued at any time.

During the three months ended September 30, 2007, the Company did not repurchase any shares of the Company's common stock.



**Table of Contents****9. Stock-Based Compensation**

On March 26, 2007, the board of directors adopted the JMP Group Inc. 2007 Equity Incentive Plan ( JMP Group 2007 Plan ), which was approved by the stockholders on April 12, 2007. JMP Group Inc. authorized the issuance of 4,000,000 shares of its common stock under this Plan. This amount may be increased by any shares JMP Group Inc. purchases on the open market, or through any share repurchase or share exchange program as well as any shares that may be returned to the JMP Group LLC 2004 Equity Incentive Plan ( JMP Group 2004 Plan ) as a result of forfeiture, termination or expiration of awards; not to exceed a maximum aggregate number of shares of 2,960,000 shares under the JMP Group 2004 Plan.

*Stock Options*

On July 18, 2006, a total of 50,000 options to purchase Class B common interests were granted to two employees who were not members of the Predecessor. The options have an exercise price of \$12.50 per share, an exercise period of seven years and will vest and become exercisable 25% at each of the four subsequent anniversaries of the grant date. The fair value of the employee option grants has been estimated on the date of grant using the Black-Scholes Option Valuation methodology with the following assumptions: expected life of options of 4.70 years, risk-free interest rate of 5.10%, dividend yield of 4.4% and volatility of 28.0%. The dividend estimate was based on the recurring base dividend and special dividend estimated for 2006 and deemed to be representative for future periods. The Predecessor used the volatility of comparable public companies to estimate the volatility. The fair value of the options granted in July 2006 is \$2.03 for each option or \$101,500 for all options granted.

On December 19, 2006, a total of 1,370,000 options to purchase Class B common interests were granted to a number of employee members and non-members of the Predecessor. The options have an exercise price of \$12.50 per share, and an exercise period of seven years. These options became vested and immediately exercisable on an accelerated basis in connection with the Reorganization. The fair value of each employee option grant was estimated on the grant date as \$3.01 by using the Black-Scholes Option Valuation methodology with the following assumptions: expected life of options of 4.75 years, risk-free interest rate of 4.67%, dividend yield of 4.0% and volatility of 31.2%. The dividend estimate was based on the recurring base dividend and special dividend estimated for 2006 and deemed to be representative for future periods. The Predecessor used the volatility of comparable public companies to estimate the volatility.

On January 5, 2007, a total of 50,000 options to purchase Class B common interests were granted to several members and non-member employees of the Predecessor. The options have an exercise price of \$12.50 per share, and an exercise period of seven years. These options became vested and immediately exercisable on an accelerated basis in connection with the Reorganization. The fair value of each employee option was estimated on the grant date as \$3.01 by using the Black-Scholes Option Valuation methodology with the following assumptions: expected life of options of 4.75 years, risk-free interest rate of 4.67%, expected dividend yield of 4.0% and volatility of 31.2%.

On January 31, 2007, a total of 25,000 options to purchase Class B common interests were granted to a member employee of the Predecessor. The options have an exercise price of \$12.50 per share and an exercise period of seven years. These options became vested and immediately exercisable on an accelerated basis in connection with the Reorganization. The fair value of each employee option was estimated on the grant date as \$3.01 by using the Black-Scholes Option Valuation methodology with the following assumptions: expected life of options of 4.75 years, risk-free interest rate of 4.67%, expected dividend yield of 4.0% and volatility of 31.2%.

In connection with the Reorganization, all outstanding options to purchase Class B common interests were exchanged into options of the Successor's common stock and the Company accelerated the vesting of 1,335,000 stock options granted in December 2006 and January 2007.

The following table summarizes the stock option activity for the nine months ended September 30, 2007 and 2006:

|                              | Nine Months Ended September 30, |                                 |                |                                 |
|------------------------------|---------------------------------|---------------------------------|----------------|---------------------------------|
|                              | 2007                            |                                 | 2006           |                                 |
|                              | Shares Subject                  | Weighted Average Exercise Price | Shares Subject | Weighted Average Exercise Price |
|                              | to Option                       |                                 | to Option      |                                 |
| Balance, beginning of period | 2,639,940                       | \$ 11.44                        | 1,242,140      | \$ 10.16                        |
| Granted                      | 75,000                          | \$ 12.50                        | 50,000         | \$ 12.50                        |
| Exercised                    |                                 | \$                              |                | \$                              |

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|                                      |           |          |           |          |
|--------------------------------------|-----------|----------|-----------|----------|
| Forfeited                            | (233,488) | \$ 11.18 | (22,200)  | \$ 10.00 |
| Expired                              | (39,162)  | \$ 12.23 |           | \$       |
| Balance, end of period               | 2,442,290 | \$ 11.48 | 1,269,940 | \$ 10.30 |
| Options exercisable at end of period | 1,645,272 | \$ 12.15 | 50,000    | \$ 15.00 |

| As of September 30, 2007     |                    |                               |               |                                 |                                |                    |                                 |                                 |                         |
|------------------------------|--------------------|-------------------------------|---------------|---------------------------------|--------------------------------|--------------------|---------------------------------|---------------------------------|-------------------------|
| Options Outstanding Weighted |                    |                               |               |                                 | Options Vested and Exercisable |                    |                                 |                                 |                         |
| Range of Exercise Prices     | Number Outstanding | Average Remaining Contractual |               | Weighted Average Exercise Price | Aggregate Intrinsic Value      | Number Exercisable | Average Remaining Contractual   |                                 | Average Intrinsic Value |
|                              |                    | Life in Years                 | Life in Years |                                 |                                |                    | Weighted Average Exercise Price | Weighted Average Exercise Price |                         |
| \$10.00 - \$15.00            | 2,442,290          | 6.99                          |               | \$ 11.48                        | \$                             | 1,645,272          | 6.44                            | \$ 12.15                        | \$                      |

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In accordance with the requirements of SFAS 123R and FIN 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*, the Successor and the Predecessor recognize stock-based compensation expense for stock options over the graded vesting period of the options using the accelerated attribution method, resulting in compensation expense as follows:

| Three Months Ended September 30, 2007 | Three Months Ended September 30, 2006 | Nine Months Ended September 30, 2007 |   | Nine Months Ended September 30, 2006 |
|---------------------------------------|---------------------------------------|--------------------------------------|---|--------------------------------------|
|                                       |                                       | January 1, 2007 through May 15, 2007 | May 16, 2007 through September 30, 2007 |                                      |
| Successor                             | Predecessor                           | Predecessor                          | Successor                               | Predecessor                          |
| \$14,839                              | \$ 32,431                             | \$ 740,120                           | \$ 3,234,351                            | \$ 74,605                            |

Included in compensation expense in the table above is stock-based compensation expense of \$3,211,835 that the Successor recognized in connection with the initial public offering in May 2007, resulting from the acceleration of the vesting of 1,335,000 stock options.

As of September 30, 2007, there was \$152,350 of unrecognized compensation expense related to stock options expected to be recognized over a weighted average period of 2.25 years.

*Restricted Stock Units*

The Company granted restricted stock units ( RSUs ) in connection with the initial public offering, and intends to do so as part of the Company's annual bonus compensation process. RSUs are subject to a vesting schedule, and such vesting is subject to the employees' continued employment with the Company. In the event of a change in control or corporate transaction, the RSUs will vest immediately prior to the effective date of such an event. Upon termination of service for any reason, all unvested RSUs will be forfeited.

On May 15, 2007, upon pricing of its initial public offering, the Company granted RSUs to a broad group of its employees and each of its two independent directors with respect to which an aggregate of 1,931,060 shares of the Company's common stock are deliverable. Awards granted under the JMP Group 2004 Plan totaled 431,060 units and awards granted under the JMP Group 2007 Plan totaled 1,500,000 units. At the time of the initial public offering, 38,642 RSUs vested immediately, with the remaining 1,892,418 RSUs vesting over four years. The RSUs granted to employees will vest 25%, 35% and 40% on the second, third and fourth anniversary of the initial public offering, respectively. The RSUs granted to the independent directors vested 33% on date of the initial public offering, and will vest 33% on each of the subsequent two anniversaries of the date of the initial public offering. The fair value of RSUs was based on the initial public offering price of \$11.00 and discounted for future dividends expected not to be received by unvested RSUs over the vesting period.

On August 7, 2007, 18,000 RSUs were granted to an independent director. Of these units, 33% vested immediately on grant date, with the balance vesting 33% on each of the two subsequent anniversaries. On September 5, 2007, additional RSUs were granted to a new hire employee, 50% of these units will vest on January 31, 2009 with the balance vesting on January 31, 2010. The fair values of these units were based on the market values of the underlying stock on the respective grant dates.

The Predecessor recorded \$0 and \$76,129, respectively, in non-cash compensation expense for the three and nine month periods ended September 30, 2007 in connection with the vesting of the award of RSUs granted on the initial public offering date. The Successor recorded \$1,409,218 and \$2,577,699, respectively, in non-cash compensation expense for the three and nine months ended September 30, 2007, in connection with the vesting of the award of RSUs granted on the initial public offering date. In addition, the Successor recorded \$100,601 in non-cash compensation expense for the three and nine months ended September 30, 2007 for RSUs granted post-initial public offering.

As of September 30, 2007, there was \$18,178,579 of unrecognized compensation expense related to RSUs expected to be recognized over a weighted average period of 3.49 years.

The following table summarizes the restricted stock unit activity for the nine months ended September 30, 2007:

| Nine Months Ended September 30, 2007 | Weighted Average Grant Date Fair Value |
|--------------------------------------|--|
|--------------------------------------|--|

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|                              |           |    |       |
|------------------------------|-----------|----|-------|
| Balance, beginning of period |           | \$ |       |
| Granted                      | 2,096,438 | \$ | 10.30 |
| Vested                       | (44,642)  | \$ | 10.00 |
| Forfeited                    | (65,210)  | \$ | 10.43 |
| Balance, end of period       | 1,986,586 | \$ | 10.30 |



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As a result of the vesting of 44,642 RSUs for the nine months ended September 30, 2007, the Company recognized current tax benefits of \$190,896.

**10. Net Income per Share of Common Stock and Net Income (Loss) per Unit Attributable to Class A and Class B Common Interests**

The Company calculates its net income per share, and the Predecessor calculated its net income (loss) per unit attributable to Class A and Class B common interests, in accordance with SFAS 128, *Earnings per Share*.

Basic net income per share for the Company is calculated by dividing net income by the weighted average number of common shares outstanding for the reporting period. Diluted net income per share is calculated by adjusting the weighted average number of outstanding shares to reflect the potential dilutive impact as if all potentially dilutive stock options or restricted stock units were exercised or converted.

Basic net income (loss) per unit for the Predecessor is calculated by dividing net income (loss) attributable to Class A and Class B common interests by the weighted average number of units of Class A and Class B common interests outstanding for the reporting period. Diluted net income (loss) per unit is computed similarly, except that it reflects the potential dilutive impact that would occur if potentially dilutive securities were exercised or converted into membership interests. To determine an average market price for applying the treasury stock method, the Predecessor estimated the fair market value of the Predecessor's Class B common interests based on trades of Class B common interests between third parties and earnings multiples of publicly traded comparables.

In August 2004, the Predecessor issued 2,300,000 units of Class B common interests in a private offering, which represented 15.5% of the Predecessor's membership interests. Because there is a direct relationship between the number of Class B common interests outstanding and the ownership percentage in the Predecessor's equity, it was possible to determine the number of units associated with the Class A common interests outstanding. As a result, the Predecessor was able to determine net income (loss) per unit, based on an implied number of Class A common interests and an existing number of Class B common interests outstanding. Pursuant to SFAS 128, *Earnings per Share*, paragraph 133 and SEC Staff Accounting Bulletin Topic 4-C, the Predecessor has reflected this capital structure for purposes of determining net income (loss) per unit in all periods presented.

The computations of basic and diluted net income per share and basic and diluted net income per unit for the three months ended September 30, 2007 and 2006 are shown in the table below:

|   | Three Months Ended<br>September 30, 2007<br>Successor | Three Months Ended<br>September 30, 2006<br>Predecessor |                   |
|---|---|---|-------------------|
|   |   | Class A<br>Common                                       | Class B<br>Common |
| <b><u>Numerator:</u></b>  |   |   |                   |
| Net income  | \$ 1,135,447  | \$ 329,848  | \$ 528,374        |
| <b><u>Denominator:</u></b>  |   |   |                   |
| Basic weighted average Class A and Class B common units Outstanding   |   | 1,435,820   | 2,300,000         |
| Basic weighted average shares outstanding                             | 22,029,098  |   |                   |
| Effect of potential dilutive securities:                              |   |   |                   |
| Options to purchase Class B common interests                          |   | 55,765  | 89,328            |
| Options to purchase common shares                                     |   |   |                   |
| Restricted stock units  |   |   |                   |
| Diluted weighted average Class A and Class B common units Outstanding |   | 1,491,585   | 2,389,328         |

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|  |                      |
|--|----------------------|
| Diluted weighted average shares outstanding                              | 22,029,098           |
| Net income per unit attributable to Class A and Class B common Interests |                      |
| Basic  | \$ 0.23      \$ 0.23 |
| Diluted  | \$ 0.22      \$ 0.22 |
| Net income per share   |                      |
| Basic  | \$ 0.05              |
| Diluted  | \$ 0.05              |

Stock options to purchase 2,478,180 shares of common stock and 860,810 Class B common interests for the three months ended September 30, 2007 and September 30, 2006 respectively, were anti-dilutive. RSU options to purchase 1,906,635 shares of common stock and no Class B interests for the three months ended September 30, 2007 and September 30, 2006, respectively, were anti-dilutive. As such, these were not included in the computation of diluted common shares or diluted common units outstanding.

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The computations of basic and diluted net income per share and basic and diluted net (loss) income per unit for the nine months ended September 30, 2007 and 2006 are shown in the table below:

|   | Nine Months Ended September 30, 2007 |                   |  | Nine Months Ended                |                                  |
|---|--------------------------------------|-------------------|--|----------------------------------|----------------------------------|
|   | January 1, 2007                      |                   | May 16, 2007<br>through September 30,<br>2007<br>Successor | September 30,                    |                                  |
|   | through May 15,                      |                   |  | 2006                             |                                  |
|   | Class A<br>Common                    | Class B<br>Common |  | Predecessor<br>Class A<br>Common | Predecessor<br>Class B<br>Common |
| <b><u>Numerator:</u></b>  |                                      |                   |  |                                  |                                  |
| Net (loss) income   | \$ (56,860,528)                      | \$ (54,836,785)   | \$ 3,901,502   | \$ 920,308                       | \$ 1,476,661                     |
| <b><u>Denominator:</u></b>  |                                      |                   |  |                                  |                                  |
| Basic weighted average Class A and Class B common units                         |                                      |                   |  |                                  |                                  |
| Outstanding   | 2,384,881                            | 2,300,000         |  | 1,433,444                        | 2,300,000                        |
| Basic weighted average shares outstanding                                       |                                      |                   | 22,027,845   |                                  |                                  |
| Effect of potential dilutive securities:  |                                      |                   |  |                                  |                                  |
| Options to purchase Class B common interests                                    |                                      |                   |  | 18,569                           | 29,795                           |
| Options to purchase common shares   |                                      |                   |  |                                  |                                  |
| Restricted stock units  |                                      |                   | 56,994   |                                  |                                  |
| Diluted weighted average Class A and Class B common units Outstanding           |                                      |                   |  |                                  |                                  |
|   | 2,384,881                            | 2,300,000         |  | 1,452,013                        | 2,329,795                        |
| Diluted weighted average shares outstanding                                     |                                      |                   | 22,084,839   |                                  |                                  |
| Net (loss) income per unit attributable to Class A and Class B common Interests |                                      |                   |  |                                  |                                  |
| Basic   | \$ (23.84)                           | \$ (23.84)        |  | \$ 0.64                          | \$ 0.64                          |
| Diluted   | \$ (23.84)                           | \$ (23.84)        |  | \$ 0.63                          | \$ 0.63                          |
| Net income per share  |                                      |                   |  |                                  |                                  |
| Basic   |                                      |                   | \$ 0.18  |                                  |                                  |
| Diluted   |                                      |                   | \$ 0.18  |                                  |                                  |

Stock options to purchase 1,474,677 and 860,810 Class B common interests for the period from January 1 through May 15, 2007 and the nine months ended September 30, 2006, respectively, as well as stock options to purchase 2,502,484 shares of common stock for the period from May 16 through September 30, 2007 were anti-dilutive and, therefore, were not included in the computation of diluted common units or diluted common shares outstanding.

**11. Employee Benefits**

All salaried employees of the Company are eligible to participate in the JMP Group 401(k) Plan after three months of employment. Participants may contribute up to the limits set by the United States Internal Revenue Service. There were no contributions by the Company during the nine months ended September 30, 2007 and 2006.

**12. Income Taxes**

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Prior to the Reorganization, all income and losses of JMP Group LLC, the Predecessor, were reportable by the individual members of JMP Group LLC in accordance with the Internal Revenue Code of the United States and, as required under generally accepted accounting principles. The U.S. federal and state income taxes payable by the members based upon their share of JMP Group LLC's net income have not been reflected in the accompanying financial statements for periods prior to the Reorganization. JMP Holdings Inc., being a C-corporation from its inception in August 2004, was subject to U.S. federal and state income taxes on its taxable income, and in accordance with Statement of Financial Standards No. 109, *Accounting for Income Taxes* ( SFAS 109 ), accounted for income taxes in its separate financial statements. SFAS 109 requires the recognition of deferred tax assets and liabilities based upon temporary differences between the financial reporting and tax bases of the Company's assets and liabilities. Valuation allowances are established when necessary to reduce deferred tax assets when it is more likely than not that a portion or all of the deferred tax assets will not be realized.

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As a result of the Reorganization, JMP Group Inc. (formerly JMP Holdings Inc.) succeeded to the business of the Predecessor. The Company is subject to U.S. federal and state income taxes on all taxable income earned subsequent to May 15, 2007 by JMP Group LLC and its subsidiaries. As a result of the Reorganization, upon the change of tax status of JMP Group LLC from a partnership to a wholly-owned disregarded entity of the Company, the Company recognized a one-time tax benefit of \$4,316,892 in connection with the establishment of net deferred tax items of \$10,739,292. For the three and nine month periods ended September 30, 2007, the Company recorded a total tax expense (benefit) of \$1,006,408 and (\$4,332,431), respectively, which included the one-time tax benefit.

The components of the Successor's income tax expense (benefit) for the period ended September 30, 2007 are as follows:

|  | <b>Three Months Ended<br/>September 30,<br/>2007<br/>Successor</b> | <b>May 16, 2007<br/>through September 30,<br/>2007<br/>Successor</b> |
|--|--|--|
| Federal                                    | \$   | \$   |
| State                                      |  |  |
| <b>Total current tax expense (benefit)</b> |  |  |
| Federal                                    | 1,041,356  | (3,536,931)  |
| State                                      | (34,948)   | (795,500)  |
| Total deferred tax expense (benefit)       | 1,006,408  | (4,332,431)  |
| <b>Total income tax expense (benefit)</b>  | <b>\$ 1,006,408</b>  | <b>\$ (4,332,431)</b>  |

A reconciliation of the statutory U.S. federal income tax rate to the Successor's effective tax rate for the period ended September 30, 2007 is as follows:

|  | <b>Three Months Ended<br/>September 30,<br/>2007<br/>Successor</b> | <b>May 16, 2007<br/>through September 30,<br/>2007<br/>Successor</b> |
|--|--|--|
| Tax at federal statutory tax rate                              | 35.00%   | 35.00%   |
| State income tax, net of federal tax                           | 5.75%  | 5.75%  |
| Adjustment for permanent items                                 | 2.35%  | -18.06%  |
| Rate before one-time events                                    | 43.10%   | 22.69%   |
| Deferred tax written off related to expired options            | 2.52%  | -12.53%  |
| Adjustment for prior year taxes                                | -7.14%   | 35.78%   |
| Deferred tax recognized upon JMP Group LLC's tax status change | 8.52%  | 959.44%  |
| Effective tax rate   | 47.00%   | 1,005.38%  |

As of September 30, 2007, the components of deferred tax assets and liabilities are as follows:

**September 30, 2007  
Successor**

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|   |              |
|---|--------------|
| Deferred tax assets:                      |              |
| Accrued compensation and related expenses | \$ 105,005   |
| Equity based compensation                 | 2,608,687    |
| Depreciation and amortization             | 202,145      |
| Reserves and allowances                   | 387,517      |
| Net unrealized capital losses             | 217,130      |
| Net operating loss carryforward (1)       | 1,829,892    |
| Other                                     | 20,672       |
| <br>                                      |              |
| Total deferred tax assets                 | 5,371,048    |
| Deferred tax liabilities:                 |              |
| Investment in partnerships                | (949,004)    |
| <br>                                      |              |
| Total deferred tax liabilities            | (949,004)    |
| Valuation allowance                       |              |
| <br>                                      |              |
| Net deferred tax assets (2)               | \$ 4,422,044 |

- (1) The net operating loss carryforward is attributable to the Successor's loss, excluding minority interest and before income tax benefit, for the period from May 16, 2007 through September 30, 2007.
- (2) The Successor had a net deferred tax asset balance of \$242,933 on May 16, 2007.

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The Company adopted FIN 48 on May 16, 2007, the date the Company became subject to federal and state income taxes. Its adoption did not have a material impact on the Company's financial condition or results of operations.

**13. Commitments and Contingencies**

The Company leases office space in California, Illinois, Georgia, Massachusetts and New York under various operating leases. Rental expense for the quarter ended September 30, 2007 was \$472,758 and \$467,645 for the quarter ended September 30, 2006. Rental expense for the nine months ended September 30, 2007 was \$699,774 for the period of January 1, 2007 through May 15, 2007, \$706,035 for the period of May 16, 2007 through September 30, 2007, and \$1,381,244 for the nine months ended September 30, 2006.

The California and New York leases included a period of free rent at the start of the lease for seven months and three months, respectively. Rent expense is recognized over the entire lease uniformly net of the free rent savings. The aggregate minimum future commitments of these leases are:

|   |              |
|---|--------------|
| October 1, 2007 through December 31, 2007 | \$ 501,515   |
| 2008                                      | 1,994,728    |
| 2009                                      | 2,250,368    |
| 2010                                      | 2,250,368    |
| 2011                                      | 1,625,711    |
|   | \$ 8,622,690 |

In connection with its underwriting activities, JMP Securities enters into firm commitments for the purchase of securities in return for a fee. These commitments require JMP Securities to purchase securities at a specified price. Securities underwriting exposes JMP Securities to market and credit risk, primarily in the event that, for any reason, securities purchased by JMP Securities cannot be distributed at anticipated price levels. At September 30, 2007, JMP Securities had no open underwriting commitments.

The securities owned and the restricted cash as well as the cash held by the clearing broker, may be used to maintain margin requirements. At September 30, 2007 and December 31, 2006, the Company had \$255,336 of cash on deposit, respectively, with JMP Securities' clearing broker. Furthermore, the securities owned may be hypothecated or borrowed by the clearing broker.

The Company had committed \$10,260,000 in capital to JMPRT, of which, as of September 30, 2007, all had been drawn. On August 7, 2007, JMPRT called the final \$6,156,000, which was paid on August 14, 2007. Accordingly, the Company has funded its entire initial capital commitment to JMPRT. The Company has an additional capital commitment of \$161,865 related to its investment in a private investment fund.

**14. Regulatory Requirements**

JMP Securities is subject to the SEC's Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital, as defined, and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. JMP Securities had net capital of \$37,865,523 and \$33,936,970, which were \$37,249,023 and \$33,420,970 in excess of the required net capital of \$616,500 and \$516,000 at September 30, 2007 and December 31, 2006, respectively. JMP Securities' ratio of aggregate indebtedness to net capital was 0.22 to 1 and 0.10 to 1 at September 30, 2007 and December 31, 2006, respectively.

Since all customer transactions are cleared through another broker-dealer on a fully disclosed basis, JMP Securities is not required to maintain a separate bank account for the exclusive benefit of customers in accordance with Rule 15c3-3 under the Exchange Act.

**15. Related Party Transactions**

The Company earns base management fees and incentive fees from serving as investment advisor for partnerships and offshore investment companies in which it also owns an investment. Base management fees from these activities were \$765,700 and \$2,089,959, and \$609,181 and \$2,101,514 for the three and nine months ended September 30, 2007 and 2006, respectively. Also, JMPAM earned incentive fees of \$203,136 and \$675,545 and \$279,990 and \$315,435 from these partnerships and offshore investment companies for three and nine months ended September 30, 2007 and 2006, respectively.





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### **16. Guarantees**

JMP Securities has agreed to indemnify its clearing broker for losses that the clearing broker may sustain from the accounts of customers introduced by JMP Securities. Should a customer not fulfill its obligation on a transaction, JMP Securities may be required to buy or sell securities at prevailing market prices in the future on behalf of its customer. JMP Securities' obligation under the indemnification has no maximum amount. All unsettled trades at September 30, 2007 had settled with no resulting liability to the Company. For the three and nine months ended September 30, 2007 and 2006, the Company did not have a loss due to counterparty failure, and has no obligations outstanding under the indemnification arrangement as of September 30, 2007.

The Company is engaged in various investment banking and brokerage activities whose counterparties primarily include broker-dealers, banks and other financial institutions. In the event counterparties do not fulfill their obligations, the Company may be exposed to risk. The risk of default depends on the creditworthiness of the counterparty or issuer of the instrument. It is the Company's policy to review, as necessary, the credit standing of each counterparty with which it conducts business.

### **17. Litigation**

Due to the nature of its business, the Company is subject to various threatened or filed legal actions. For example, because we act as an underwriter or a financial advisor in the ordinary course of our business, we have in the past been, currently are and may in the future be subject to class action claims that seek substantial damages.

In addition, defending employment claims against us could require the expenditure of substantial resources. Such litigation is inherently uncertain and the ultimate resolution of such litigation could be determined by factors outside of our control. Management, after consultation with legal counsel, believes that the currently known actions or threats will not result in any material adverse effect on the Company's financial condition, results of operations or cash flows.

### **18. Financial Instruments with Off-Balance Sheet Risk, Credit Risk or Market Risk**

The majority of the Company's transactions, and consequently the concentration of its credit exposure, is with its clearing broker. The clearing broker is also a significant source of short-term financing for the Company, which is collateralized by cash and securities owned by the Company and held by the clearing broker. The Company's securities owned may be pledged by the clearing broker. The receivable from the clearing broker represents amounts receivable in connection with the trading of proprietary positions.

The Company is also exposed to credit risk from other brokers, dealers and other financial institutions with which it transacts business. In the event that counterparties do not fulfill their obligations, the Company may be exposed to credit risk.

The Company's trading activities include providing securities brokerage services to institutional clients. To facilitate these customer transactions, the Company purchases proprietary securities positions (long positions) in equity securities. The Company also enters into transactions to sell securities not yet purchased (short positions), which are recorded as liabilities on the Consolidated Statements of Financial Condition. The Company is exposed to market risk on these long and short securities positions as a result of decreases in market value of long positions and increases in market value of short positions. Short positions create a liability to purchase the security in the market at prevailing prices. Such transactions result in off-balance sheet market risk as the Company's ultimate obligation to satisfy the sale of securities sold, but not yet purchased may exceed the amount recorded in the Consolidated Statements of Financial Condition. To mitigate the risk of losses, these securities positions are marked to market daily and are monitored by management to assure compliance with limits established by the Company.

### **19. Business Segments**

The Company's business results are categorized into the following two segments: Broker-Dealer and Asset Management. The Broker-Dealer segment includes a broad range of services, such as underwriting and acting as a placement agent for public and private capital raising transactions and financial advisory services in M&A, restructuring and other strategic transactions. The Broker-Dealer segment also includes institutional brokerage services and equity research services to our institutional investor clients. The Asset Management segment includes the management of a broad range of pooled investment vehicles, including the Company's hedge funds, funds of funds and JMPRT as well as the Company's principal investments in public and private securities.

The accounting policies of the segments are consistent with those described in the Significant Accounting Policies in Note 2.

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Revenue generating activities between segments are eliminated from the segment results for reporting purposes. These activities include fees paid by the Broker-Dealer segment to the Asset Management segment for the management of its investment portfolio.

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The Company's segment information for the three and nine month periods ended September 30, 2007 and 2006 was prepared using the following methodology:

Revenues and expenses directly associated with each segment are included in determining income.

Revenues and expenses not directly associated with a specific segment are allocated based on the most relevant measures applicable, including revenues, headcount and other factors.

Each segment's operating expenses include: a) compensation and benefits expenses that are incurred directly in support of the segments and b) other operating expenses, which include expenses for premises and occupancy, professional fees, travel and entertainment, communications and information services, equipment and indirect support costs (including compensation and other operating expenses related thereto) for administrative services.

Corporate operating expenses include income allocation and accretion - Redeemable Class A member interests and interest expense payable on Redeemable Class A member interests. These expenses are not allocated to the segments, because Redeemable Class A member interests are capital to the Company as a whole and the income allocation is based on the Company's consolidated results. The Company evaluates segment results based on revenue and segment operating income before minority interest and taxes.

**Segment Operating Results**

Management believes that the following information provides a reasonable representation of each segment's contribution to revenues, income and assets:

|                            | Nine Months Ended September 30, 2007 |                                     |                                    |                                       |                                    |
|----------------------------|--------------------------------------|-------------------------------------|------------------------------------|---------------------------------------|------------------------------------|
|                            | Three Months Ended<br>September 30,  | Three Months Ended<br>September 30, | January 1, 2007<br>through May 15, | May 16, 2007<br>through September 30, | Nine Months Ended<br>September 30, |
|                            | 2007<br>Successor                    | 2006<br>Predecessor                 | 2007<br>Predecessor                | 2007<br>Successor                     | 2006<br>Predecessor                |
| <b>Broker-Dealer</b>       |                                      |                                     |                                    |                                       |                                    |
| Revenues                   | \$ 18,961,786                        | \$ 18,710,041                       | \$ 30,114,149                      | \$ 30,888,324                         | \$ 59,347,303                      |
| Operating expenses         | 16,782,699                           | 14,962,288                          | 24,013,904                         | 31,032,004                            | 48,432,060                         |
| Segment operating income   | \$ 2,179,087                         | \$ 3,747,753                        | \$ 6,100,245                       | \$ (143,680)                          | \$ 10,915,243                      |
| Segment assets             | \$ 94,284,715                        | \$ 67,516,718                       | N/A                                | \$ 94,284,715                         | \$ 67,516,718                      |
| <b>Asset Management</b>    |                                      |                                     |                                    |                                       |                                    |
| Revenues                   | \$ 2,046,090                         | \$ 1,745,658                        | \$ 2,257,862                       | \$ 2,775,289                          | \$ 4,323,791                       |
| Operating expenses         | 1,779,601                            | 1,626,505                           | 1,925,177                          | 2,833,280                             | 4,107,009                          |
| Segment operating income   | \$ 266,489                           | \$ 119,153                          | \$ 332,685                         | \$ (57,991)                           | \$ 216,782                         |
| Segment assets             | \$ 85,754,806                        | \$ 21,762,495                       | N/A                                | \$ 85,754,806                         | \$ 21,762,495                      |
| <b>Corporate</b>           |                                      |                                     |                                    |                                       |                                    |
| Operating expenses         | \$                                   | \$ 2,915,367                        | \$ 117,962,855                     | \$                                    | \$ 8,638,807                       |
| <b>Consolidated Entity</b> |                                      |                                     |                                    |                                       |                                    |
| Revenues                   | 21,007,876                           | 20,455,699                          | 32,372,011                         | 33,663,613                            | 63,671,094                         |
| Operating expenses         | 18,562,300                           | 19,504,160                          | 143,901,936                        | 33,865,284                            | 61,177,876                         |

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|   |    |             |    |            |                  |    |             |    |            |
|---|----|-------------|----|------------|------------------|----|-------------|----|------------|
| Income (loss) before income tax benefit and minority interest | \$ | 2,445,576   | \$ | 951,539    | \$ (111,529,925) | \$ | (201,671)   | \$ | 2,493,218  |
| Total assets  | \$ | 180,039,521 | \$ | 89,279,213 | N/A              | \$ | 180,039,521 | \$ | 89,279,213 |

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### **20. Subsequent Events**

On August 7, 2007, the Company's board of directors authorized the repurchase of up to one million shares of the Company's outstanding common stock during the next twelve months. On November 6, 2007, the Company's board of directors increased the Company's authorization under its share repurchase program by 500,000 shares, making the total number of shares authorized for repurchase equal to 1.5 million. In addition, the board extended the duration of the program until December 31, 2008.

During the month of October 2007, the Company repurchased 83,425 shares of the Company's common stock at an average price of \$7.29 per share for an aggregate purchase price of \$607,837.

On November 6, 2007, the Company's board of directors declared a cash dividend of \$0.05 per share of common stock for the third quarter of 2007 to be paid on December 14, 2007 to common shareholders of record on November 30, 2007.

### **21. Pro Forma Financial Information**

As described below and elsewhere in this quarterly report on Form 10-Q, the historical results of operations for periods prior to May 16, 2007, the date of the Reorganization, are not comparable to results of operations for subsequent periods. Accordingly, management believes that the inclusion of pro forma financial information is useful to compare the results of the Company prior and subsequent to the Reorganization, as though the Company had operated as a C-corporation for the nine month period ended September 30, 2007. This pro forma financial information is not intended to represent, and should not be considered more meaningful than, or as an alternative to, measures determined in accordance with GAAP.

The following unaudited Condensed Consolidated Pro Forma Statements of Net (Loss) Income for the nine month period ended September 30, 2007 present the consolidated results of operations of JMP Group Inc. assuming that the Reorganization described under Organization and Description of Business had been completed as of the close of business on December 31, 2006. The pro forma adjustments are based on available information and upon assumptions that our management believes are reasonable in order to reflect, on a pro forma basis, the impact of the reorganization transactions on the historical financial information of JMP Group Inc. The adjustments are described in the notes to the unaudited Condensed Consolidated Pro Forma Statements of Net (Loss) Income.

The pro forma adjustments for the Reorganization principally give effect to the following items:

The add-back of the income allocation and accretion expense related to Redeemable Class A member interests which would not have been recorded if the Redeemable Class A member interests had been converted into common stock in connection with the Reorganization as of the close of business on December 31, 2006.

The add-back of interest expense related to Redeemable Class A member interests because, as a corporation, the Company no longer pays any interest on prior employee members' capital.

An adjustment for income tax expense as if the Company had been a corporation for the periods presented, at an assumed combined federal, state and local income tax rate of 42%.

The assumed exchange of Redeemable Class A member interests and Class A and Class B common interests into common stock of the Company in accordance with the Operating Agreement.

The unaudited condensed consolidated pro forma financial information of JMP Group Inc. should be read together with Management's Discussion and Analysis of Financial Condition and Results of Operations and the JMP Group Inc. historical financial statements and related notes included elsewhere in this Form 10-Q.

The unaudited condensed consolidated pro forma financial information is included for informational purposes only and does not purport to reflect the results of operations that would have occurred had we operated as a public company during the periods presented. The unaudited condensed consolidated pro forma financial information also does not project the results of operations for any future period or date.



**Table of Contents****JMP GROUP INC.****Condensed Consolidated Pro Forma****Statement of Net (Loss) Income****For The Nine Months Ended September 30, 2007****(Unaudited)**

|  | January 1, 2007 through May 15, 2007 |  | May 16, 2007 through September 30, 2007                |               | Nine Months<br>Ended<br>September 30,<br>2007<br>Pro Forma,<br>as Adjusted |   |               |
|--|--------------------------------------|--|--|---------------|--|---|---------------|
|  | Historical                           | Pro Forma<br>Adjustments<br>For the<br>Reorganization<br>Predecessor | Pro Forma,<br>as Adjusted<br>For the<br>Reorganization | Historical    | Pro Forma,<br>as Adjusted<br>For the<br>Reorganization<br>Successor        | Pro Forma,<br>as Adjusted<br>For the<br>Reorganization<br>Predecessor/<br>Successor<br>Combined * |               |
| Total revenues   | \$ 32,372,011                        | \$   | \$ 32,372,011  | \$ 33,663,613 | \$   | \$ 33,663,613   | \$ 66,035,624 |
| Expenses:  |                                      |  |  |               |  |   |               |
| Compensation and benefits  | 18,393,339                           |  | 18,393,339   | 24,772,727    |  | 24,772,727  | 43,166,066    |
| Income allocation and accretion -<br>Redeemable Class A member interests | 117,418,274                          | (117,418,274)(1)   |  |               |  |   |               |
| Administration   | 1,770,553                            |  | 1,770,553  | 2,128,853     |  | 2,128,853   | 3,899,406     |
| Brokerage, clearing and exchange fees                                    | 1,689,174                            |  | 1,689,174  | 1,896,307     |  | 1,896,307   | 3,585,481     |
| Interest and dividend expense  | 683,114                              | (544,581)(2)   | 138,533  | 170,156       |  | 170,156   | 308,689       |
| Other expenses   | 3,947,482                            |  | 3,947,482  | 4,897,241     |  | 4,897,241   | 8,844,723     |
| Total expenses   | 143,901,936                          | (117,962,855)  | 25,939,081   | 33,865,284    |  | 33,865,284  | 59,804,365    |
| Income before income taxes and minority<br>interest                      | (111,529,925)                        | 117,962,855  | 6,432,930  | (201,671)     |  | (201,671)   | 6,231,259     |
| Provision for income taxes/ (Income tax<br>benefit)                      |                                      | 2,701,831(3)   | 2,701,831  | (4,332,431)   | 4,247,729(3)   | (84,702)  | 2,617,129     |
| Minority interest  | 167,388                              |  | 167,388  | 229,258       |  | 229,258   | 396,646       |
| Net (loss) income  | \$ (111,697,313)                     | \$ 115,261,024   | \$ 3,563,711   | \$ 3,901,502  | \$ (4,247,729)   | \$ (346,227)  | \$ 3,217,484  |
| Net income per share of common stock:                                    |                                      |  |  |               |  |   |               |
| Basic pro forma  |                                      |  | \$ 0.24  | \$ 0.18       |  | \$ (0.02)   | \$ 0.17       |
| Diluted pro forma  |                                      |  | \$ 0.24  | \$ 0.18       |  | \$ (0.02)   | \$ 0.17       |
| Weighted average shares of common<br>stock outstanding:                  |                                      |  |  |               |  |   |               |
| Basic pro forma  |                                      |  | 14,800,035(4)  | 22,027,845(4) |  | 22,027,845(4)   | 18,453,653(4) |
| Diluted pro forma  |                                      |  | 14,905,435(4)  | 22,084,839(4) |  | 22,084,839(4)   | 18,534,584(4) |

\* Represents aggregate Successor and Predecessor results for the period presented. The combined results are non-GAAP financial measures and should not be used in isolation or substitution of Successor and Predecessor results.

**Table of Contents****JMP GROUP INC.****Notes to Condensed Consolidated Pro Forma Statement of Net (Loss) Income****(Unaudited)**

- (1) As a limited liability company, income and paid profit distributions of the Predecessor were allocated based on the pro rata ownership percentage to the holders of the Redeemable Class A member interests. In connection with the Reorganization, the Redeemable Class A member interests were exchanged into shares of the Company's common stock and reclassified from liability to equity. Hence, the Company will no longer incur income allocation and accretion expense, and will no longer pay pro rata profit distributions to the prior holders of the Predecessor's membership interests, but instead will pay dividends, if any, to all its shareholders.

The Predecessor's Redeemable Class A member interests had been accounted for as a liability as required by SFAS 123R, prior to the Reorganization. In connection with the liability-to-equity modification of the Redeemable A member interests, the Predecessor was required to mark the interests to its fair market value. Marking the Redeemable A member interests to fair market value resulted in a one-time non-cash expense of \$112.9 million, which was charged to Income allocation and accretion - Redeemable Class A member interests on the books of the Predecessor. This expense represented the difference between (a) the equity amount recorded for the 10,109,957 shares of common stock issued in exchange for the Redeemable Class A member interests and (b) the carrying amount of the Redeemable Class A member interests prior to the Reorganization.

In addition to the one-time non-cash expense, income allocation and accretion Redeemable Class A member interests includes \$4.5 million for the nine months ended September 30, 2007, related to the Predecessor income allocated to the Redeemable Class A member interests.

- (2) As a limited liability company, the Predecessor made interest payments based on contributed capital to the holders of the Redeemable Class A member interests. As a corporation, the Redeemable Class A member interests were exchanged into shares of the Company's common stock, and the Company will therefore no longer make interest payments to the holders of the Redeemable Class A member interests.
- (3) As a limited liability company, the Predecessor was not subject to income taxes. An adjustment has been made to include assumed income taxes for the Company at an effective tax rate of 42%, reflecting assumed federal, state and local income taxes.
- (4) For purposes of the pro forma income per share calculation, the weighted average shares outstanding, basic and diluted, are calculated based on:

|  | <b>Nine Months Ended September 30, 2007</b> |   |                               |
|--|---|---|-------------------------------|
|  | <b>January 1, 2007<br/>through</b>          | <b>May 16, 2007<br/>through</b>         |                               |
|  | <b>May 15, 2007<br/>Predecessor</b>         | <b>September 30, 2007<br/>Successor</b> | <b>Pro Forma<br/>Combined</b> |
| Weighted average basic shares outstanding    | 14,800,035(a)                               | 22,027,845                              | 18,453,653                    |
| Effect of potential dilutive securities:     |   |   |                               |
| Options to purchase Class B common interests | 105,400(b)                                  |   | 52,121                        |
| Options to purchase common shares            |   |   |                               |
| Restricted stock units                       |   | 56,994                                  | 28,810                        |
| Weighted average diluted shares outstanding  | 14,905,435                                  | 22,084,839                              | 18,534,584                    |



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- (a) Reflects an adjustment for the issuance of shares of the Company's common stock to members of JMP Group LLC in exchange for their respective membership interests in the Reorganization. The 2,300,000 basic units of Class B common interests outstanding represented 15.5% of the Predecessor's ownership and were exchanged into common shares of the Company at an exchange ratio of one-for-one. Class A common interests and Redeemable Class A member interests are assumed to be exchanged into common shares of the Company by applying the same one-for-one exchange ratio to the respective ownership percentages represented by such interests.
  
- (b) Diluted shares outstanding include the dilutive impact of options to acquire Class B common interests converted at a one-for-one ratio for options to acquire shares of the Company's common stock.

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### **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read together with the unaudited consolidated financial statements and the related notes included elsewhere in this report. For additional context with which to understand our financial condition and results of operations, refer to the MD&A for the fiscal year ended December 31, 2006 contained in our Registration Statement on Form S-1 (Commission File No. 333-140689).

#### **Cautionary Statement Regarding Forward Looking Statements**

This MD&A and other sections of this report contain forward looking statements. In some cases, you can identify these statements by forward-looking words such as may, might, will, should, expect, plan, anticipate, believe, estimate, predict, potential or could and other comparable terminology. These forward-looking statements, which are based on various underlying assumptions and expectations and are subject to risks, uncertainties and other unknown factors, may include projections of our future financial performance based on our growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events that we believe to be reasonable. There are or may be important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the historical or future results, level of activity, performance or achievements expressed or implied by such forward-looking statements. These factors include, but are not limited to, those discussed under the caption "Risk Factors" in our Registration Statement on Form S-1 (File No. 333-140689). We are under no duty to update any of these forward-looking statements after the date of filing of this report to conform such forward-looking statements to actual results or revised expectations.

#### **Overview**

We are a full-service investment banking and asset management firm headquartered in San Francisco. We have a diversified business model with a focus on small and middle-market companies and provide:

investment banking, including corporate finance, mergers and acquisitions and other strategic advisory services, to corporate clients;

Sales and trading, and related brokerage services to institutional investors;

proprietary equity research in our six target industries; and

Asset management products and services to institutional investors, high net-worth individuals and for our own account.

#### **Corporate Reorganization**

Prior to May 16, 2007 the Company had conducted its business through a multi-member Delaware limited liability company, JMP Group LLC, or the Predecessor, pursuant to its Third Amended and Restated Limited Liability Company Operating Agreement dated as of August 18, 2004, as amended, or the Operating Agreement. One of JMP Group LLC's members, JMP Holdings Inc., was established in August 2004 to enable investors to invest through a corporate entity in the membership interests of JMP Group LLC. Shares of common stock of JMP Holdings were issued in a private offering in August 2004. JMP Holdings' only significant asset until May 16, 2007 was its investment in JMP Group LLC, comprised of the member interests of JMP Group LLC purchased with the net proceeds received from issuance of JMP Holdings' common stock.

In connection with its initial public offering, JMP Holdings changed its name to JMP Group Inc., and effective May 16, 2007, members of JMP Group LLC exchanged the outstanding membership interests of JMP Group LLC for shares of common stock of JMP Group Inc. As a result of the exchange, JMP Group LLC became JMP Group Inc.'s wholly-owned subsidiary and JMP Group Inc., or the Successor, completed its initial public offering on May 16, 2007. This corporate reorganization ( "Reorganization" ) is described in greater detail in the Registration Statement on Form S-1 (File No. 333-140689) filed with the Securities and Exchange Commission in connection with the initial public offering.

#### **Predecessor and Successor**

We have presented our historical financial results for the Predecessor and the Successor in the financial statements for the periods before and after the Reorganization on May 16, 2007. Despite the separate presentation, there were no material changes to the actual operations or customer

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relationships of our business as a result of the exchange of the membership interests of the Predecessor for shares of common stock of the Successor and the initial public offering of the Successor.

As the core operations of the Company have not changed as a result of the Reorganization, when evaluating our results of operations and financial performance, our management views the nine months ended September 30, 2007 as a single measurement period, rather than the two separate periods that are required to be reported under GAAP. We believe that comparisons between the Predecessor's results for the nine months ended September 30, 2006 and either the Predecessor's results for the period from January 1, 2007 to May 15, 2007 or the Successor's results for the period from May 16, 2007 to September 30, 2007, may not provide users of our financial statements with all the information they may need to fully understand our operating and cash flow performance.

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Consequently, to enhance the analysis of our operating results and cash flows, we have presented the operating results and cash flows of the Predecessor for the nine months ended September 30, 2006 and of the Predecessor and Successor on a combined basis for the nine month periods ended September 30, 2007. This combined presentation for the nine months ended September 30, 2007 represents a non-GAAP mathematical addition of the pre-reorganization results of operations and statements of cash flow of the Predecessor for the period from January 1, 2007 to May 15, 2007 and the results of operations and statements of cash flow of the Successor for the period from May 16, 2007 to September 30, 2007. The Successor conducted no material operational activities from the date of formation of JMP Holdings Inc. until the combination with JMP Group LLC on May 16, 2007. We believe that the combined presentation provides additional information investors can use to conduct a meaningful comparison of operating results and cash flows between periods. A reconciliation showing the mathematical combination of our operating results for such periods is included below under the headings Results of Operations and Liquidity and Capital Resources.

### **Components of Revenues**

We derive revenues primarily from fees earned from our investment banking business, net commissions on our trading activities in our sales and trading business, and asset management fees in our asset management business. We also generate revenues from principal transactions, interest, dividends, and other income.

#### *Investment Banking*

We earn investment banking revenues from underwriting securities offerings, arranging private placements and providing advisory services in mergers and acquisitions and other strategic advisory assignments.

#### *Underwriting Revenues*

We earn underwriting revenues from securities offerings in which we act as an underwriter, such as initial public offerings and follow-on equity offerings. Underwriting revenues include management fees, underwriting fees and selling concessions. We record underwriting revenues, net of related syndicate expenses, at the time the underwriting is completed. In syndicated underwritten transactions, management estimates our share of transaction-related expenses incurred by the syndicate, and we recognize revenues net of such expense. On final settlement by the lead manager, typically 90 days from the trade date of the transaction, we adjust these amounts to reflect the actual transaction-related expenses and our resulting underwriting fee. We receive a higher proportion of total fees in underwritten transactions in which we act as a lead manager.

#### *Strategic Advisory Revenues*

Our strategic advisory revenues primarily include success fees on closed merger and acquisition transactions, as well as retainer fees, earned in connection with advising both buyers and sellers transactions. We also earn fees for related advisory work and other services such as providing fairness opinions and valuation analyses. We record strategic advisory revenues when the transactions or the services (or, if applicable, separate components thereof) to be performed are substantially complete, the fees are determinable and collection is reasonably assured.

#### *Private Placement Revenues*

We earn agency placement fees in non-underwritten transactions such as private placements of equity securities, private investments in public equity, or PIPEs, Rule 144A private offerings and trust preferred securities offerings. We record private placement revenues on the closing date of these transactions.

Since our investment banking revenues are generally recognized at the time of completion of each transaction or the services to be performed, these revenues typically vary between periods and may be considerably affected by the timing of the closing of significant transactions.

**Table of Contents***Brokerage Revenues*

Our brokerage revenues include commissions paid by customers from brokerage transactions in exchange-listed and over-the-counter, or OTC, equity securities. Commissions are recognized on a trade date basis. Brokerage revenues also include net trading gains and losses that result from market making activities and from our commitment of capital to facilitate customer transactions. Our brokerage revenues may vary between periods, in part depending on commission rates, trading volumes and our ability to continue to deliver research and other value-added services to our clients. The ability to execute trades electronically, through the Internet and through other alternative trading systems has increased pressure on trading commissions and spreads. We expect this trend toward alternative trading systems and pricing pressures in our brokerage business to continue. We are, to some extent, compensated through brokerage commissions for the value of research and other value added services we deliver to our clients. These "soft dollar" practices have been the subject of discussion among regulators, the investment banking community and our sales and trading clients. In particular, commission sharing arrangements have been adopted by some large institutional investors. In these arrangements, these institutional investors concentrate their trading with fewer "execution" brokers and pay a fixed amount for execution with an additional amount set aside for payments to other firms for research or other brokerage services. Accordingly, we may experience reduced (or eliminated) trading volume with such investors but may be compensated for our research and sales efforts through allocations of the designated amounts. Depending on the extent to which we adopt this practice and depending on our ability to reach arrangements on terms acceptable to us, this trend would likely impair the revenues and profitability of our commission business by negatively affecting both volumes and trading commissions in our commission business.

*Asset Management Fees*

Asset management fees include base management fees and incentive fees earned from managing investment partnerships sponsored by us and investment accounts owned by clients. Base management fees earned by us are generally based on the fair value of assets under management and the fee schedule for each fund and account. We also earn incentive fees that are based upon the performance of investment funds and accounts. Such fees are based on a percentage of the excess of an investment return over a specified highwater mark or hurdle rate over a defined performance period.

Our asset management revenues are subject to fluctuations due to a variety of factors that are unpredictable, including the overall condition of the economy and the securities markets as a whole and our core sectors. These conditions can have a material effect on the inflows and outflows of assets under management, and the performance of our asset management funds. For example, a significant portion of the performance-based or incentive revenues that we recognize are based on the value of securities held in the funds we manage. The value of these securities includes unrealized gains or losses that may change from one period to another.

The following table presents certain information with respect to the investment funds managed by JMPAM:

|                                     | <b>Company's Share of Net Asset Value at</b> |                          |
|-------------------------------------|--|--------------------------|
|                                     | <b>September 30, 2007</b>                    | <b>December 31, 2006</b> |
|                                     | <b>Successor</b>                             | <b>Predecessor</b>       |
| <b>Funds Managed by JMPAM:</b>      |  |                          |
| <b>Hedge Funds:</b>                 |  |                          |
| Harvest Opportunity Partners II     | \$ 8,951,962                                 | \$ 6,464,500             |
| Harvest Value Income Plus           | 3,103,636                                    | 2,247,237                |
| Harvest Small Cap Partners          | 10,126,176                                   | 3,073,844                |
| Harvest Consumer Partners *         | 1,711,722                                    | 889,169                  |
| Harvest Technology Partners *       | 2,880,844                                    | 546,415                  |
| <b>Funds of Funds:</b>              |  |                          |
| JMP Masters Fund                    | 3,215,697                                    | 583,143                  |
| JMP Emerging Masters Fund           | 1,034,786                                    |                          |
| <b>REIT:</b>                        |  |                          |
| JMP Realty Trust *                  | 9,215,214                                    | 2,059,714                |
| <b>Total funds managed by JMPAM</b> | <b>\$ 40,240,037</b>                         | <b>\$ 15,864,022</b>     |

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\* The Company's share of net asset value in HTP, HCP and JMPRT is consolidated in the Company's Statements of Financial Condition, net of minority interest.

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|                                 | Three Months Ended September 30, 2007                   |                                      |                                     |
|---------------------------------|---|--------------------------------------|-------------------------------------|
|                                 | Company's Share of<br>Change in Fair Value<br>Successor | JMPAM<br>Management Fee<br>Successor | JMPAM<br>Incentive Fee<br>Successor |
| <b>Hedge Funds:</b>             |   |                                      |                                     |
| Harvest Opportunity Partners II | \$ (85,106)   | \$ 302,202                           | \$                                  |
| Harvest Value Income Plus       | (147,556)   | 30,468                               |                                     |
| Harvest Small Cap Partners      | 437,478   | 122,406                              | 192,570                             |
| Harvest Consumer Partners *     | (8,905)   | 4,969                                | 409                                 |
| Harvest Technology Partners *   | 129,355   | 3,188                                | 7,739                               |
| <b>Funds of Funds:</b>          |   |                                      |                                     |
| JMP Masters Fund                | 72,772  | 228,183                              | 2,418                               |
| JMP Emerging Masters Fund       | 34,786  | 25,298                               |                                     |
| <b>REIT:</b>                    |   |                                      |                                     |
| JMP Realty Trust *              | 174,598   | 48,986                               |                                     |
| Totals                          | \$ 607,422  | \$ 765,700                           | \$ 203,136                          |

|                                 | Nine Months Ended September 30, 2007                               |   |  |   |  |   |
|---------------------------------|--|---|--|---|--|---|
|                                 | Company's Share of<br>Change in Fair Value                         |   | JMPAM Management Fee   |   | JMPAM Incentive Fee  |   |
|                                 | January<br>1,<br>2007<br>through<br>May 15,<br>2007<br>Predecessor | May 16, 2007<br>through<br>September 30,<br>2007<br>Successor | January<br>1,<br>2007<br>through<br>May 15,<br>2007<br>Predecessor | May 16, 2007<br>through<br>September 30,<br>2007<br>Successor | January<br>1,<br>2007<br>through<br>May 15,<br>2007<br>Predecessor | May 16, 2007<br>through<br>September 30,<br>2007<br>Successor |
| <b>Hedge Funds:</b>             |  |   |  |   |  |   |
| Harvest Opportunity Partners II | \$ 46,774  | \$ (159,489)  | \$ 466,787   | \$ 458,770  | \$   | \$ 176  |
| Harvest Value Income Plus       | 38,676   | (188,101)   | 56,980   | 46,185  |  | 5,825   |
| Harvest Small Cap Partners      | 481,461  | 747,751   | 90,988   | 165,171   | 226,956  | 396,165   |
| Harvest Consumer Partners *     | 28,146   | (41,403)  | 7,458  | 7,488   | 4,522  | 409   |
| Harvest Technology Partners *   | 34,628   | 114,105   | 4,828  | 4,817   | 8,835  | 7,739   |
| <b>Funds of Funds:</b>          |  |   |  |   |  |   |
| JMP Masters Fund                | 50,842   | 81,712  | 286,346  | 337,302   | 20,223   | 2,418   |
| JMP Emerging Masters Fund       |  | 34,786  | 36,854   | 41,024  | 2,012  | 265   |
| <b>REIT:</b>                    |  |   |  |   |  |   |
| JMP Realty Trust *              | 14,373   | 157,083   | 22,512   | 56,449  |  |   |
| Totals                          | \$ 694,900   | \$ 746,444  | \$ 972,753   | \$ 1,117,206  | \$ 262,548   | \$ 412,997  |

\* Revenues earned from HTP, HCP and JMPRT are consolidated in the Company's Statements of Net Income (loss), net of minority interest. As of September 30, 2007, the contractual base management fees earned from each of these investment funds ranged between 1% and 2% of assets under management. The contractual incentive fees were generally 20%, subject to highwater marks, for the hedge funds, 5% to 10%, subject to highwater marks, for the funds of funds, and 25%, subject to a performance hurdle rate, for JMPRT.

*Principal Transactions*

Principal transactions revenues includes realized and unrealized net gains and losses resulting from our principal investments, which includes investments in equity securities for our own account and as the general partner of funds managed by us, warrants we may receive from certain investment banking assignments, as well as limited partner investments in private funds managed by third parties. In addition, we invest a portion of our capital in a portfolio of equity securities managed by JMP Asset Management and in side-by-side investments in the funds managed by us. In certain cases, we also co-invest alongside our institutional clients in private transactions resulting from our investment banking business.

*Interest, Dividends and Other Income*

Interest, dividends and other income includes interest and dividend income generated by our liquid assets and principal investments. Other income also includes fees earned to raise capital for third-party investment partnerships, or funds.



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### **Components of Expenses**

We classify our expenses as compensation and benefits, income allocation and accretion/(dilution) Redeemable Class A member interests, administration expense, brokerage, clearing and exchange fees, interest and dividend expense and other expenses. A significant portion of our expense base is variable, including compensation and benefits, brokerage and clearance, communication and data processing, and travel and entertainment expenses.

#### *Compensation and Benefits*

Compensation and benefits is the largest component of our expenses and includes employees base pay, performance bonuses, sales commissions, related payroll taxes, medical and benefits expenses, as well as expenses for contractors, temporary employees and equity-based compensation. Our employees receive the majority of their compensation in the form of individual performance-based bonuses. As is the widespread practice in our industry, we pay bonuses on an annual basis, which for senior professionals typically make up a large portion of their total compensation. Compensation is accrued based on a ratio of total compensation and benefits to total revenues. We accrue for the estimated amount of these bonus payments ratably over the applicable service period. Bonus payments may have a greater impact on our cash position and liquidity in the periods in which they are paid than would otherwise be reflected in our Consolidated Statements of Net Income (Loss). We expect that our compensation and benefits expense, excluding equity-based awards made prior to and in connection with our initial public offering, will be approximately 60% of revenues each year, although we may change this rate at any time.

#### *Income Allocation and Accretion/(Dilution) Redeemable Class A Member Interests*

Redeemable Class A member interests were issued to our former employee members and such interests were entitled to share in our income. Each holder of the Redeemable Class A member interest was a party to our Third Amended and Restated Limited Liability Company Agreement, as amended, which provided that an employee member could have elected to redeem his or her Redeemable Class A member interests without our consent in connection with such person's resignation from us. Because of this repurchase feature, the Redeemable Class A member interests were classified as a liability and measured at each balance sheet date based on the redemption amounts for the Redeemable Class A member interests. The redemption amount for a former employee member was the amount we would have been required to pay to that former employee member upon resignation to redeem all of his or her Redeemable Class A member interests, and was equal to the capital account of such former employee member as maintained by us.

Redeemable Class A member interests were accounted for as stock-based compensation and classified as a liability. As a result, the share of our income allocated to Redeemable Class A member interests, based on the membership percentage owned, and any additional changes in the redemption amount of Redeemable Class A member interests was recorded as Income allocation and accretion/(dilution) Redeemable Class A member interests in our consolidated statements of income.

In connection with the Reorganization, the Redeemable Class A member interests were exchanged for shares of our common stock and reclassified from liability to equity. The liability-to-equity exchange of the Redeemable Class A member interests required the Predecessor to mark the liability for the Redeemable Class A member interests to its fair market value and to record a non-cash expense related to the change in value. The Predecessor accounted for the exchange in its consolidated financial statements as follows:

The Predecessor recorded a one-time non-cash expense as a component of Income allocation and accretion Redeemable Class A member interests equal to \$112.9 million, which represents the difference between (a) the equity amount recorded for the shares of common stock issued in exchange for the Redeemable Class A member interests and (b) the carrying amount of the Redeemable Class A member interests prior to the Reorganization; and then

The Predecessor recorded additional equity equal to \$111.2 million for the 10,109,957 shares of common stock exchanged for the Redeemable Class A member interests based on the initial public offering price of \$11.00 per share.

#### *Administration*

Administration expense primarily includes the cost of hosted conferences, non-capitalized systems and software expenditures, insurance, business tax (non-income), office supplies, recruiting, and regulatory fees.

*Brokerage, Clearing and Exchange Fees*

Brokerage, clearing and exchange fees include the cost of floor and electronic brokerage and execution, securities clearance, and exchange fees. We currently clear our securities transactions through Ridge Clearing. Changes in brokerage, clearing and exchange fees fluctuate largely in line with the volume of sales and trading activity.

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### *Interest and Dividend Expense*

Interest and dividend expense consisted primarily of interest paid on capital contributed by our Predecessor's employee members, who received interest payments at an annual rate equal to the Prime rate plus 100 basis points until the Reorganization. To a lesser extent it results from short-term borrowings and dividend paying short positions in our principal investment portfolio. When we completed our Reorganization on May 16, 2007, our Redeemable Class A member interests were exchanged into shares of our common stock and thus we no longer make interest payments to the former holders of the Redeemable Class A member interests.

### *Other Expenses*

Other operating expenses primarily include travel and business development, market data, occupancy, legal and accounting professional fees and depreciation.

### *Minority Interest*

Minority interest relates to the interest of third parties in JMP Realty Trust and in two of our asset management funds, Harvest Consumer Partners and Harvest Technology Partners. JMP Realty Trust is a real estate investment trust that was formed in June 2006. JMP Realty Trust is managed by JMP Asset Management. Because of the current ownership and external management position, we consolidate JMP Realty Trust and record a minority interest. JMP Asset Management is also the general partner of Harvest Consumer Partners and Harvest Technology Partners. Due to our ownership and resulting control by JMP Asset Management and related parties, management believes that limited partners currently do not have substantive rights to remove the general partner, and, therefore, these two funds are consolidated in the financial statements and minority interest is recorded.

## **Historical Results of Operations**

The following table sets forth our historical results of operations for the three and nine month periods ended September 30, 2007 and 2006 and is not necessarily indicative of the results to be expected for any future period.

For purposes of comparing the nine month periods ended September 30, 2007 and 2006 discussed herein, we have aggregated the Predecessor period from January 1, 2007 through May 15, 2007 and the Successor period from May 16, 2007 through September 30, 2007, without further adjustment. The supplemental aggregate disclosures and discussions are not in accordance with, or an alternative for, generally accepted accounting principles, and are provided solely for the purpose of providing additional supplemental information.

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| <i>(in thousands)</i>   | Three Months Ended                 |                                      | Change from |         |
|---|------------------------------------|--------------------------------------|-------------|---------|
|   | September 30,<br>2007<br>Successor | September 30,<br>2006<br>Predecessor | \$          | %       |
| Revenues  |                                    |                                      |             |         |
| Investment banking  | \$ 9,401                           | \$ 8,806                             | \$ 595      | 6.8%    |
| Brokerage   | 8,173                              | 8,406                                | (233)       | -2.8%   |
| Asset management fees   | 942                                | 875                                  | 67          | 7.7%    |
| Principal transactions  | 855                                | 1,257                                | (402)       | -32.0%  |
| Interest, dividends and other income                                | 1,637                              | 1,112                                | 525         | 47.2%   |
| Total revenues  | 21,008                             | 20,456                               | 552         | 2.7%    |
| Expenses  |                                    |                                      |             |         |
| Compensation and benefits   | 13,027                             | 11,663                               | 1,364       | 11.7%   |
| Income allocation and accretion Redeemable Class A member interests |                                    | 2,504                                | (2,504)     | -100.0% |
| Administration  | 1,249                              | 953                                  | 296         | 31.1%   |
| Brokerage, clearing and exchange fees                               | 1,289                              | 1,065                                | 224         | 21.0%   |
| Interest and dividend expense                                       | 111                                | 437                                  | (326)       | -74.6%  |
| Other   | 2,886                              | 2,883                                | 3           | 0.1%    |
| Total expenses  | 18,562                             | 19,505                               | (943)       | -4.8%   |
| Income before income tax expense and minority interest              | 2,446                              | 951                                  | 1,495       | 157.1%  |
| Income tax expense  | 1,007                              |                                      | 1,007       | N/A     |
| Minority interest   | 304                                | 93                                   | 211         | 226.9%  |
| Net income  | \$ 1,135                           | \$ 858                               | \$ 277      | 32.2%   |

**Nine Months Ended September 30, 2007**

| <i>(in thousands)</i>   | January 1, 2007 through May 15, 2007 |           |              | May 16, 2007 through September 30, 2007 |              | Combined  |             | September 30, 2006 |              | Change from 2006 to 2007 |  |
|---|--------------------------------------|-----------|--------------|---|--------------|-----------|-------------|--------------------|--------------|--------------------------|--|
|   | 2007                                 |           | 2007         |   | Predecessor/ |           | 2006        |                    | 2006 to 2007 |                          |  |
|   | Predecessor                          | Successor | Predecessor/ | Successor                               | Predecessor  | Successor | Predecessor | Successor          | \$           | %                        |  |
| Revenues  |                                      |           |              |   |              |           |             |                    |              |                          |  |
| Investment banking  | \$ 16,055                            | \$ 16,863 | \$ 32,918    | \$ 33,543                               | \$ (625)     | -1.9%     |             |                    |              |                          |  |
| Brokerage   | 12,987                               | 12,243    | 25,230       | 22,772                                  | 2,458        | 10.8%     |             |                    |              |                          |  |
| Asset management fees   | 1,218                                | 1,502     | 2,720        | 2,475                                   | 245          | 9.9%      |             |                    |              |                          |  |
| Principal transactions  | 541                                  | 685       | 1,226        | 2,369                                   | (1,143)      | -48.2%    |             |                    |              |                          |  |
| Interest, dividends and other income                                | 1,571                                | 2,370     | 3,941        | 2,512                                   | 1,429        | 56.9%     |             |                    |              |                          |  |
| Total revenues  | 32,372                               | 33,663    | 66,035       | 63,671                                  | 2,364        | 3.7%      |             |                    |              |                          |  |
| Expenses  |                                      |           |              |   |              |           |             |                    |              |                          |  |
| Compensation and benefits   | 18,393                               | 24,773    | 43,166       | 37,627                                  | 5,539        | 14.7%     |             |                    |              |                          |  |
| Income allocation and accretion Redeemable Class A member interests | 117,418                              |           | 117,418      | 7,505                                   | 109,913      | N/A       |             |                    |              |                          |  |
| Administration  | 1,771                                | 2,129     | 3,900        | 3,187                                   | 713          | 22.4%     |             |                    |              |                          |  |
| Brokerage, clearing and exchange fees                               | 1,689                                | 1,896     | 3,585        | 2,993                                   | 592          | 19.8%     |             |                    |              |                          |  |
| Interest and dividend expense                                       | 683                                  | 170       | 853          | 1,169                                   | (316)        | -27.0%    |             |                    |              |                          |  |
| Other   | 3,948                                | 4,896     | 8,844        | 8,697                                   | 147          | 1.7%      |             |                    |              |                          |  |
| Total expenses  | 143,902                              | 33,864    | 177,766      | 61,178                                  | 116,588      | 190.6%    |             |                    |              |                          |  |

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|   |              |          |              |          |              |        |
|---|--------------|----------|--------------|----------|--------------|--------|
| (Loss) income before income tax benefit and minority interest | (111,530)    | (201)    | (111,731)    | 2,493    | (114,224)    | N/A    |
| Income tax benefit  |              | (4,332)  | (4,332)      |          | (4,332)      | N/A    |
| Minority interest   | 167          | 229      | 396          | 96       | 300          | 312.5% |
| Net (loss) income   | \$ (111,697) | \$ 3,902 | \$ (107,795) | \$ 2,397 | \$ (110,192) | N/A    |

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### **Three Months Ended September 30, 2007, Compared to Three Months Ended September 30, 2006**

#### *Overview*

Total revenues increased \$0.5 million, or 2.7%, from \$20.5 million for the quarter ended September 30, 2006 to \$21.0 million for the quarter ended September 30, 2007. The increase was primarily due to an increase in investment banking revenue of \$0.6 million and interest, dividends and other income of \$0.5 million, partially offset by a decrease in principal transactions revenue of \$0.4 million.

Total expenses decreased by \$0.9 million, or 4.8%, from \$19.5 million for the quarter ended September 30, 2006 to \$18.6 million for the quarter ended September 30, 2007, primarily because we discontinued recognizing income allocated to the Redeemable Class A member interests after the Reorganization. This resulted in a decrease in income allocation and accretion/(dilution) expense of \$2.5 million, partially offset by an increase in compensation and benefits of \$1.4 million.

Net income increased \$0.3 million from \$0.9 million for the quarter ended September 30, 2006 to \$1.1 million for the quarter ended September 30, 2007, primarily as a result of the aforementioned \$2.5 million decrease in income allocation accretion/(dilution) expense.

#### **Revenues**

##### *Investment Banking*

Investment banking revenues increased \$0.6 million, or 6.8%, from \$8.8 million for the quarter ended September 30, 2006 to \$9.4 million for the same period in 2007, and increased as a percentage of total revenues from 43.0% to 44.7%, respectively. The increase in revenues reflects a higher level of activity and increased revenue in our public equity underwriting business, partially offset by decreased revenues in both our strategic advisory and private placement businesses. Public equity underwriting revenues increased by \$3.5 million, or 340.3%, from \$1.1 million for the quarter ended September 30, 2006 to \$4.6 million for the quarter ended September 30, 2007. We executed eight public equity underwriting transactions in the quarter ended September 30, 2007 compared to three in the quarter ended September 30, 2006. In addition, we acted as a lead manager on three public equity underwriting transactions in the quarter ended September 30, 2007, compared with none in the quarter ended September 30, 2006. Our strategic advisory revenues decreased \$2.3 million, or 47.6%, from \$4.8 million for the quarter ended September 30, 2006 to \$2.5 million for the quarter ended September 30, 2007, due to fewer transactions executed in the third quarter of 2007 compared to the third quarter of 2006, of which three and six transactions were executed, respectively. Average revenues per strategic advisory transaction, however, increased 4.9%. Private placement revenues decreased \$0.7 million, or 23.9%, from \$2.9 million for the quarter ended September 30, 2006 to \$2.2 million for the quarter ended September 30, 2007. The decrease was primarily due to fewer executed originations of trust preferred securities and to lower average revenues per private placement transaction in the quarter ended September 30, 2007, compared to the quarter ended September 30, 2006.

##### *Brokerage Revenues*

Brokerage revenues decreased by \$0.2 million, or 2.8%, from \$8.4 million for the quarter ended September 30, 2006 to \$8.2 million for the quarter ended September 30, 2007. The decrease was a result of an increase in trading losses, partially offset by higher gross commission revenue for the quarter ended September 30, 2007 compared to the quarter ended September 30, 2006. The increase in commissions resulted from increased trading activity with existing clients, and the addition of new institutional clients during the period. The increase in trading losses resulted from taking more frequent positions in greater amounts to facilitate customer trades, increased market making activities, as well as market volatility in the third quarter 2007. Brokerage revenues decreased as a percentage of total revenues, from 41.1% for the quarter ended September 30, 2006 to 38.9% for the quarter ended September 30, 2007.

##### *Asset Management Fees*

Asset management fees remained at \$0.9 million for the quarter ended September 30, 2006 and the quarter ended September 30, 2007. Asset management fees include both base management fees and incentive fees for our funds under management. An increase in base management fees from the quarter ended September 30, 2006 to the quarter ended September 30, 2007 was partially offset by a decrease in incentive fees. The increase in base management fees is the result of an increase in assets under management from \$206.5 million as of September 30, 2006 to \$221.7 million as of September 30, 2007. As a percentage of total revenues, asset management fees increased from 4.3% for the quarter ended September 30, 2006 to 4.5% for the same period in 2007.

##### *Principal Transactions*

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Principal transaction revenues decreased \$0.4 million from a gain of \$1.3 million for the quarter ended September 30, 2006 to a gain of \$0.9 million for the quarter ended September 30, 2007. The decrease was due to a decrease in gains from equity investments in publicly held securities of \$0.5 million, as well as a decrease of \$0.1 million in gains from investment partnerships, attributable to the performance of the funds managed by us. The decrease in gains was partially offset by an increase of \$0.2 million in gain related to the value of warrant positions, which reflect the market performance of the companies in which we hold warrants.

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### *Interest, Dividends and Other Income*

Interest, dividends and other income increased \$0.5 million, or 47.2%, from \$1.1 million for the quarter ended September 30, 2006 to \$1.6 million for the same period in 2007. The increase was primarily attributable to investing \$55.0 million of proceeds from our initial public offering in short duration AAA rated securities, as well as to higher market interest rates, more active cash management, and an increased capital allocation to our investment portfolio, which returned higher interest and dividend income as a percent of total invested capital.

### **Expenses**

#### *Compensation and Benefits*

Compensation and benefits, which includes salaries, commissions and performance bonus compensation to our employees, increased \$1.3 million, or 11.7%, from \$11.7 million for the quarter ended September 30, 2006 to \$13.0 million for the quarter ended September 30, 2007. Of the total compensation and benefits expense for this period, \$1.5 million is attributable to equity-based compensation expenses, comprised primarily of expense recognized for restricted stock units granted in connection with the initial public offering. The increase was partially offset by \$0.1 million in lower employee payroll and accrual for bonuses, which is primarily attributable to a lower target compensation to revenue ratio used for the accrual of bonuses during the quarter ended September 30, 2007 compared to the same quarter in 2006. Compensation and benefits as a percentage of revenues increased from 57.0% of total revenues for the quarter ended September 30, 2006 to 62.0% for the same period in 2007. Excluding expense in the amount of \$1.4 million from equity-based awards granted in connection with the initial public offering, as a percentage of revenues, compensation and benefits decreased from 57.0% of total revenues for the quarter ended September 30, 2006 to 55.3% for the same period in 2007.

#### *Income Allocation and Accretion/(Dilution)*

Income allocation and accretion/(dilution) decreased \$2.5 million from \$2.5 million for the quarter ended September 30, 2006 to none for the quarter ended September 30, 2007. Due to our Reorganization as a C-corporation in connection with our initial public offering on May 16, 2007, periods after this date no longer reflect an expense for income allocation and accretion/(dilution).

#### *Administration*

Administration expenses increased \$0.3 million, or 31.1%, from \$1.0 million for the quarter ended September 30, 2006 to \$1.3 million for the quarter ended September 30, 2007. The increase was due primarily to city and state business tax expenses in the third quarter of 2007. The increase was also due to higher insurance and other expenses associated with being a public company. Administration expense increased from 4.7% of total revenues for the quarter ended September 30, 2006 to 5.9% for the same period in 2007.

#### *Brokerage, Clearing and Exchange Fees*

Brokerage, clearing and exchange fees increased \$0.2 million, or 21.0%, from \$1.1 million for the quarter ended September 30, 2006 to \$1.3 million for the quarter ended September 30, 2007. The increase was primarily due to an increase in trading activity in our sales and trading business as total shares traded increased 56.3% from the quarter ended September 30, 2006 to the quarter ended September 30, 2007. As a percentage of total revenues, our brokerage, clearing and exchange fees increased from 5.2% for the quarter ended September 30, 2006 to 6.1% for the same period in 2007.

#### *Interest and Dividend Expense*

Interest and dividend expense decreased \$0.3 million, or 74.6%, from \$0.4 million for the quarter ended September 30, 2006 to \$0.1 million for the quarter ended September 30, 2007. The decrease was primarily due to the discontinuation of interest payments to Redeemable Class A members, as a result of the exchange into common stock at the time of the initial public offering. As a percentage of total revenues, interest and dividend expense decreased from 2.1% for the quarter ended September 30, 2006 to 0.5% for the same period in 2007.

#### *Other Expenses*

Other expenses remained unchanged at \$2.9 million for the quarters ended September 30, 2006 and 2007. The quarter ended September 30, 2007 reflected an increase of \$0.3 million in professional fees, consisting primarily of increased legal, audit and accounting expenses. This increase was offset by a similar decrease in travel and business development expense, primarily due to higher client reimbursements for investment



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banking transactions executed and closed in the quarter ended September 30, 2007. As a percentage of total revenues, other expenses decreased from 14.1% for the quarter ended September 30, 2006 to 13.7% for the same period in 2007.

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*Minority Interest*

Minority interest relates to the consolidation of JMP Realty Trust and of two of our hedge funds, Harvest Consumer Partners and Harvest Technology Partners. We recorded minority interest expense of \$0.3 million for the quarter ended September 30, 2007 compared with \$0.1 million for the quarter ended September 30, 2006, due to an improvement in the performance of JMP Realty Trust, as well as Harvest Consumer Partners and Harvest Technology Partners.

*Provision for Income Taxes*

Prior to the completion of our initial public offering on May 16, 2007, we were a limited liability company treated as a partnership; therefore, all of our income and losses were reportable by the individual members. The U.S. federal and state income taxes payable by the members based upon their share of our net income have not been reflected in the accompanying financial statements for the periods prior to the initial public offering. We were, however, subject to state and local unincorporated tax and franchise tax.

In connection with our initial public offering and Reorganization, we are subject to federal and state income taxes on all taxable income earned subsequent to May 15, 2007. Additionally, in connection with the Reorganization, we recognized a one-time tax benefit of \$4.3 million in connection with the establishment of net deferred tax asset items of \$10.7 million. In calculating the one-time tax benefit amount and associated deferred tax asset items, the Company makes reasonable estimates of its share of the 2006 taxable income and 2007 taxable income attributed to the period from January 1 through May 15, 2007 of the partnerships in which it has a direct or indirect interest. These estimates may change as additional information becomes available; as a result, the net one-time tax benefit amount may change. During the third quarter, the Company adjusted the one-time tax benefit of \$4.3 million by \$0.2 million in additional tax expense. Including the one-time tax benefit, during the three and nine months ended September 30, 2007, we recorded a total tax expense (benefit) of \$1.0 million and (\$4.3) million, respectively.

The effective tax rate for the three and nine months ended September 30, 2007 was 38.5% and 45.9%, respectively, excluding the one-time tax benefit. Including the one-time tax benefit, the effective tax rate for the three and nine months ended September 30, 2007 was 47.0% and 1,005.4%, respectively.

**Nine Months Ended September 30, 2007, Compared to Nine Months Ended September 30, 2006**

*Overview*

Total revenues increased \$2.3 million, or 3.7%, from \$63.7 million for the nine months ended September 30, 2006 to \$66.0 million for the nine months ended September 30, 2007. The increase was primarily due to higher brokerage revenues of \$2.5 million, partially offset by lower principal transactions revenues of \$1.1 million.

Total expenses increased by \$116.6 million, or 190.6%, from \$61.2 million for the nine months ended September 30, 2006 to \$177.8 million for the nine months ended September 30, 2007, primarily due to an increase in income allocation and accretion/(dilution) expense of \$109.9 million resulting from a one-time non-cash expense associated with the exchange of Redeemable Class A member interests into shares of our common stock in connection with the Reorganization at the time of our initial public offering.

Net income decreased \$110.2 million from \$2.4 million for the nine months ended September 30, 2006 to a loss of \$107.8 million for the nine months ended September 30, 2007, primarily as a result of the aforementioned \$109.9 million increase in income allocation accretion/(dilution) expense due to a one-time non-cash expense associated with the Reorganization.

**Revenues**

*Investment Banking*

Investment banking revenues decreased \$0.6 million, or 1.9%, from \$33.5 million for the nine months ended September 30, 2006 to \$32.9 million for the same period in 2007 and decreased as a percentage of total revenues from 52.7% to 49.8%, respectively. The decrease in revenues reflects a lower level of activity in our private placement business, partially offset by an increase in our public equity underwriting and strategic advisory businesses. Private placement revenues decreased \$3.7 million, or 30.0%, from \$12.3 million for the nine months ended September 30, 2006 to \$8.6 million for the nine months ended September 30, 2007. The decrease was primarily due to fewer originations of trust preferred securities executed and to lower revenues per transaction in private investments in public equity, or PIPE, transactions in the first nine months of 2007. Public equity underwriting revenues increased by \$2.1 million, or 18.2%, from \$11.5 million for the nine months ended September 30, 2006 to \$13.6 million for the nine months ended September 30, 2007. We executed twenty-five public equity underwriting

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transactions in the nine months ended September 30, 2007 compared to twenty-two in the nine months ended September 30, 2006. In addition, we acted as the lead manager on six public equity underwriting transactions, including our own initial public offering, in the nine month period ending September 30, 2007, compared with three in the same period of 2006. We recognized no revenue for acting as underwriter in our own initial public offering, and the underwriting fees were instead recorded as additional paid-in capital. Our strategic advisory revenues increased \$0.9 million, or 9.7%, from \$9.8 million for the nine months ended September 30, 2006 to \$10.7 million for the nine months ended September 30, 2007, due to an increase in average revenues per transaction executed in the first nine months of 2007 compared to the first nine months of 2006.

**Table of Contents***Brokerage Revenues*

Brokerage revenues increased by \$2.5 million, or 10.8%, from \$22.8 million for the nine months ended September 30, 2006 to \$25.2 million for the nine months ended September 30, 2007. The increase was a result of higher gross commission revenues, partially offset by higher trading losses for the nine months ended September 30, 2007 as compared to the nine months ended September 30, 2006. The increase in commissions resulted from increased trading activity with existing clients, and to the addition of new institutional clients during the period. The increase in trading losses resulted from taking more frequent positions in greater amounts to facilitate customer trades, increased market making activities, as well as market volatility. Brokerage revenues increased as a percentage of total revenues, from 35.8% for the nine months ended September 30, 2006 to 38.2% for the nine months ended September 30, 2007.

*Asset Management Fees*

Asset management fees increased by \$0.2 million, or 9.9%, from \$2.5 million for the nine months ended September 30, 2006 to \$2.7 million for the nine months ended September 30, 2007. Asset management fees include both base management fees and incentive fees for our funds under management. Lower base management fees for the nine months ended September 30, 2007 compared to the nine months ended September 30, 2006 were offset by higher incentive fees over the same period. Base management fees fell from \$2.2 million for the nine months ended September 30, 2006 to \$2.1 million for the nine months ended September 30, 2007, as the result of a shift in the composition of average assets under management from hedge funds to funds of funds, which charge lower base management fees. Incentive fees increased from \$0.3 million for the nine months ended September 30, 2006, to \$0.7 million for the same period in 2007. The increase is primarily the result of improved performance of our families of funds and from an increase in assets under management from \$206.5 million as of September 30, 2006 to \$221.7 million as of September 30, 2007. As a percentage of total revenues, asset management fees increased from 3.9% for the nine months ended September 30, 2006 to 4.1% for the same period in 2007.

*Principal Transactions*

Principal transaction revenues decreased \$1.2 million from a gain of \$2.4 million for the nine months ended September 30, 2006 to a gain of \$1.2 million for the nine months ended September 30, 2007. The decrease was due to a decline in gains from equity investments in publicly-held securities of \$1.4 million, partially offset by an increase of \$0.3 million in gains related to the value of warrant positions, which reflect the market performance of the companies for which we hold warrants. The nine months ended September 30, 2007 also included the recovery of \$0.6 million of previously written off private securities.

*Interest, Dividends and Other Income*

Interest, dividends and other income increased \$1.4 million, or 56.9%, from \$2.5 million for the nine months ended September 30, 2006 to \$3.9 million for the same period in 2007. The increase was primarily attributable to higher market interest rates, more active cash management, and an increased capital allocation to our investment portfolio, which returned higher interest and dividend income as a percent of total invested capital.

**Expenses***Compensation and Benefits*

Compensation and benefits, which includes salaries, commissions, performance bonus and equity compensation to our employees, increased \$5.6 million, or 14.7%, from \$37.6 million for the nine months ended September 30, 2006 to \$43.2 million for the nine months ended September 30, 2007. Of the total compensation and benefits expense for this period, \$5.9 million is attributable to equity-based compensation expenses related to our initial public offering, comprised of \$3.2 million in expense recognized for accelerated vesting of stock options and \$2.7 million in expense recognized for restricted stock units granted in connection with the initial public offering. In addition, a lower compensation-to-revenue ratio was used to accrue bonus compensation during the nine months ended September 30, 2007 as compared to the same nine months in 2006. Compensation and benefits increased from 59.1% of total revenues for the nine months ended September 30, 2006 to 65.4% for the same period in 2007. Excluding expense of \$5.9 million from equity-based awards accelerated and granted in connection with the initial public offering, as a percentage of revenues compensation and benefits decreased from 59.1% of total revenues for the nine months ended September 30, 2006 to 56.5% for the same period in 2007.

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**Table of Contents***Income Allocation and Accretion/(Dilution)*

Income allocation and accretion/(dilution) increased \$109.9 million from \$7.5 million for the nine months ended September 30, 2006 to \$117.4 million for the nine months ended September 30, 2007. The increase was associated with a one-time non-cash expense of \$112.9 million as a result of the exchange of Redeemable Class A member interests into shares of our common stock in connection with the Reorganization at the time of our initial public offering. Due to this one-time non-cash expense, income allocation and accretion/(dilution) increased from 11.8% of total revenues for the year ended September 30, 2006 to 177.8% for the same period in 2007. Due to our Reorganization as a C-corporation in connection with our initial public offering, periods after May 2007 will no longer reflect an expense for income allocation and accretion/(dilution).

*Administration*

Administration expenses increased \$0.7 million, or 22.4%, from \$3.2 million for the nine months ended September 30, 2006 to \$3.9 million for the nine months ended September 30, 2007. The increase was primarily due to higher 2007 expenses for our annual pre-initial public offering corporate finance and research conferences, both of which occur in the first nine months of the year. The increase was also due to city and state business taxes recorded in the first nine months of 2007 as well as higher insurance and other expenses associated with being a public company in 2007. Administration expense increased from 5.0% of total revenues for the nine months ended September 30, 2006 to 5.9% for the same period in 2007.

*Brokerage, Clearing and Exchange Fees*

Brokerage, clearing and exchange fees increased \$0.6 million, or 19.8%, from \$3.0 million for the nine months ended September 30, 2006 to \$3.6 million for the nine months ended September 30, 2007. The increase was primarily due to an increase in trading activity in our sales and trading business as total shares traded increased 60.3% from the nine months ended September 30, 2006 to the nine months ended September 30, 2007. As a percentage of total revenues, our brokerage, clearing and exchange fees increased from 4.7% for the nine months ended September 30, 2006 to 5.4% for the same period in 2007.

*Interest and Dividend Expense*

Interest and dividend expense decreased \$0.3 million, from \$1.2 million for the nine months ended September 30, 2006 to \$0.9 million for the nine months ended September 30, 2007. While the nine months ended September 30, 2007 experienced increased expense related to dividend expense from short positions in our investment portfolio, the period's results also reflect the discontinuation of interest payments to Redeemable Class A members, due to the exchange into common stock at the time of the initial public offering. As a percentage of total revenues, interest and dividend expense decreased from 1.8% for the nine months ended September 30, 2006 to 1.3% for the same period in 2007.

*Other Expenses*

Other expenses increased \$0.1 million, or 1.7%, from \$8.7 million for the nine months ended September 30, 2006 to \$8.8 million for the nine months ended September 30, 2007. The increase in other expenses was due primarily to a \$0.3 million increase in professional fees resulting from one-time audit and accounting expenses, increased legal expense, and increased expenses resulting from being a public company. The increase was partially offset by decreases in travel and entertainment expense, depreciation, and by the settlement of a previously reserved receivable in the first quarter of 2007. As a percentage of total revenues, our other expenses decreased from 13.7% for the nine months ended September 30, 2006 to 13.4% for the same period in 2007.

*Minority Interest*

We recorded minority interest expense of \$0.4 million for the nine months ended September 30, 2007, compared with \$0.1 million for the nine months ended September 30, 2006. The minority interest relates to the inception of JMP Realty Trust, which was formed in June 2006, and to the consolidation of two of our hedge funds, Harvest Consumer Partners and Harvest Technology Partners.

*Provision for Income Taxes*

Prior to the completion of our initial public offering on May 16, 2007, we were a limited liability company treated as a partnership; therefore, all of our income and losses were reportable by the individual members. The U.S. federal and state income taxes payable by the members based upon their share of our net income have not been reflected in the accompanying financial statements for the periods prior to the initial public offering. We were, however, subject to state and local unincorporated tax and franchise tax.



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In connection with our initial public offering and Reorganization, we are subject to federal and state income taxes on all taxable income earned subsequent to May 15, 2007. Additionally, in connection with the Reorganization, we recognized a one-time tax benefit of \$4.3 million in connection with the establishment of net deferred tax asset items of \$10.7 million. In calculating the one-time tax benefit amount and associated deferred tax asset items, the Company makes reasonable estimates of its share of the 2006 taxable income and 2007 taxable income attributed to the period from January 1 through May 15, 2007 of the partnerships in which it has a direct or indirect interest. These estimates may change as additional information becomes available; as a result, the net one-time tax benefit amount may change. During the third quarter, the Company adjusted the one-time tax benefit of \$4.3 million by \$0.2 million in additional tax expense. Including the one-time tax benefit, during the three and nine months ended September 30, 2007, we recorded a total tax expense (benefit) of \$1.0 million and (\$4.3) million, respectively.

The effective tax rate for the three and nine months ended September 30, 2007 was 38.5% and 45.9%, respectively, excluding the one-time tax benefit. Including the one-time tax benefit, the effective tax rate for the three and nine months ended September 30, 2007 was 47.0% and 1,005.4%, respectively.

**Liquidity and Capital Resources**

A condensed table of cash flows for the nine month periods ended September 30, 2007 and 2006 is presented below. We have aggregated the Predecessor period from January 1, 2007 through May 15, 2007 and the Successor period from May 16, 2007 through September 30, 2007, without further adjustment, for purposes of comparison with the same periods in 2006. The supplemental aggregate disclosures and discussions are not in accordance with, or an alternative for, generally accepted accounting principles, and are provided solely for the purpose of providing additional supplemental information.

|                                      | Nine Months Ended September 30, 2007 |                       |              | Nine Months         |            |              |  |
|--------------------------------------|--------------------------------------|-----------------------|--------------|---------------------|------------|--------------|--|
|                                      | January 1, 2007                      | May 16, 2007          | Combined     | Ended September 30, |            | Change from  |  |
|                                      | through May 15,                      | through September 30, | Predecessor/ | 2006                |            | 2006 to 2007 |  |
|                                      | 2007                                 | 2007                  | Successor    | Predecessor         | \$         | %            |  |
| <i>(in thousands)</i>                |                                      |                       |              |                     |            |              |  |
| Cash flows from operations           | \$ (29,821)                          | \$ 13,555             | \$ (16,266)  | \$ (10,331)         | \$ (5,935) | -57.4%       |  |
| Cash flows from investing activities | (509)                                | (14,752)              | (15,261)     | 2,653               | (17,914)   | -675.2%      |  |
| Cash flows from financing activities | 8,020                                | 66,535                | 74,555       | (1,057)             | 75,612     | N/A          |  |
| Total cash flows                     | \$ (22,310)                          | \$ 65,338             | \$ 43,028    | \$ (8,735)          | \$ 51,763  | 592.6%       |  |

We have historically satisfied our capital and liquidity requirements primarily through member contributions from our managing directors and outside investors and internally generated cash from operations. On May 16, 2007, we completed our initial public offering of common stock, raising \$73.1 million in net proceeds. The net proceeds of our initial public offering were used, in part, to make distributions in May 2007 to the Predecessor's employee members, in the amount of \$17.5 million. The Predecessor borrowed \$14.5 million from our revolving note at City National Bank to cover a portion of the distribution. The \$14.5 million note was subsequently repaid with proceeds from the initial public offering. We are using the remaining net proceeds for general corporate purposes, including supporting and expanding our existing business lines. Most of our operating cash flow is generated from our investment banking and brokerage revenues and is invested in cash and cash equivalents, marketable securities or other investments, and partnerships in which JMP Asset Management is the investment manager.

Our balance sheet is relatively liquid and unleveraged. As of September 30, 2007, we had liquid assets of \$126.7 million, primarily consisting of cash and cash equivalents, marketable securities and other investments (mainly investments in funds managed by JMP Asset Management). We have a \$30.0 million revolving line of credit with City National Bank, which had no balance outstanding as of September 30, 2007.

JMP Securities, our wholly-owned subsidiary and a registered securities broker-dealer, is subject to the net capital requirements of the SEC's Uniform Net Capital Rule. We use the basic method permitted by the Uniform Net Capital Rule to compute net capital, which generally requires that the ratio of aggregate indebtedness to net capital shall not exceed 15 to 1. SEC regulations also provide that equity capital may not be withdrawn or cash dividends paid if certain minimum net capital requirements are not met. At September 30, 2007, JMP Securities' net capital under the SEC's Uniform Net Capital Rule was \$37.9 million, or \$37.2 million in excess of the minimum required net capital.

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The timing of bonus compensation payments to our employees may significantly affect our cash position and liquidity from period to period. While our employees and managing directors are generally paid salaries semi-monthly during the year, bonus compensation payments, which make up a larger portion of total compensation, are generally paid once a year. Bonus compensation payments for a given year are generally paid at the end of January of the following year.



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The Company had committed \$10.3 million in capital to JMPRT, of which, as of September 30, 2007, all had been drawn. On August 7, 2007, JMPRT called the final \$6.1 million which was paid on August 14, 2007. Accordingly, the Company has funded its entire initial capital commitment of \$10.3 million to JMPRT. The Company has an additional capital commitment of \$0.2 million related to its investment in a private investment fund.

The Company intends to declare quarterly cash dividends on all outstanding shares of common stock. We do not plan to pay dividends on unvested shares of restricted stock. On August 7, 2007, the Company's board of directors declared a cash dividend of \$0.025 per share of common stock for the second quarter of 2007 which was paid on August 30, 2007 to common shareholders of record on August 23, 2007. This amount represents a prorated quarterly dividend for the period from the Company's initial public offering on May 16, 2007 through June 30, 2007, based upon a quarterly dividend rate of \$0.05 per share.

On November 6, 2007, the Company's board of directors declared a cash dividend of \$0.05 per share of common stock for the third quarter of 2007 to be paid on December 14, 2007 to common shareholders of record on November 30, 2007.

Because of the nature of our investment banking and sales and trading businesses, liquidity is important to us. Accordingly, we regularly monitor our liquidity position, including our cash and net capital positions. We believe that our available liquidity and current level of equity capital, combined with the net proceeds to us from the initial public offering and funds anticipated to be provided by our operating activities, will be adequate to meet our liquidity and regulatory capital requirements for the next 12 months.

**Cash Flows for the Nine Months Ended September 30, 2007**

Cash increased by \$43.0 million during the nine months ended September 30, 2007, primarily as a result of cash provided by financing activities.

Our operating activities used \$16.3 million of cash from the combined net loss of \$107.8 million, adjusted for the cash provided by the change in operating assets and liabilities of \$90.4 million. The increase in operating assets and liabilities was primarily due to the increase of Redeemable Class A member interests in connection with our initial public offering, as well as the payout of 2006 year-end bonuses in the first half of 2007.

Our investing activities used \$15.3 million, which consisted mostly of \$12.6 million of net purchases of other investments, including \$9.7 million invested in quasi-government agency securities.

Our financing activities provided \$74.6 million of cash primarily due to the net proceeds from our initial public offering.

**Cash Flows for the Nine Months Ended September 30, 2006**

Cash decreased by \$8.7 million during the nine months ended September 30, 2006, primarily as a result of cash used in operating activities.

Our operating activities used \$10.3 million of cash from net income of \$2.4 million, adjusted for the cash used in the change in operating assets and liabilities of \$12.2 million and by \$0.5 million used in non-cash revenue and expense items. The decrease in operating assets and liabilities was primarily due to the payout of 2005 year-end bonuses in the first half of 2006.

Our investing activities provided \$2.7 million, which consisted mostly of \$2.9 million of net sales of other investments.

Our financing activities used \$1.1 million of cash due to distributions to our Predecessor's common members, partially offset by capital contributions of minority interest shareholders.

**Contractual Obligations**

The following table provides a summary of our contractual obligations as of September 30, 2007:

| <b>Payments Due by Period (in 000's):</b><br><i>(in thousands)</i> | <b>Total</b> | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b> | <b>2011</b> |
|--|--------------|-------------|-------------|-------------|-------------|-------------|
| Operating lease obligations  | \$ 8,623     | \$ 502      | \$ 1,995    | \$ 2,250    | \$ 2,250    | \$ 1,626    |

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Other contractual obligations (1)

|                |          |        |          |          |          |          |
|----------------|----------|--------|----------|----------|----------|----------|
| Total payments | \$ 8,623 | \$ 502 | \$ 1,995 | \$ 2,250 | \$ 2,250 | \$ 1,626 |
|----------------|----------|--------|----------|----------|----------|----------|

(1) Excludes a capital commitment of \$0.2 million related to a private investment fund as of September 30, 2007.

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### **Off-Balance Sheet Arrangements**

We had no material off-balance sheet arrangements as of September 30, 2007. However, as described below under **Qualitative and Quantitative Disclosures About Market Risk** **Credit Risk**, through indemnification provisions in our clearing agreements with our clearing broker, customer activities may expose us to off-balance sheet credit risk, which we seek to mitigate through customer screening and collateral requirements.

### **Qualitative and Quantitative Disclosures About Market Risk**

#### *Market Risk*

Market risk represents the risk of loss that may result from the change in value of a financial instrument due to fluctuations in its market price. Market risk may be exacerbated in times of trading illiquidity when market participants refrain from transacting in normal quantities and/or at normal bid-offer spreads. Our exposure to market risk is directly related to our role as a financial intermediary in customer trading and to our market making and investment activities. Market risk is inherent in financial instruments.

Even though we trade in equity securities as an active participant in both listed and OTC markets and we make markets in over two hundred stocks, we typically maintain very few securities in inventory overnight to minimize market risk. In addition, we act as agent rather than principal whenever we can and may use a variety of risk management techniques and hedging strategies in the ordinary course of our trading business to manage our exposures. Historically, in connection with our principal investments in publicly-traded equity securities, we have engaged in short sales of equity securities to offset the risk of purchasing other equity securities. In the future, we may utilize other hedging strategies such as equity derivative trades, although we have not engaged in derivative transactions in the past.

In connection with our sales and trading business, management evaluates the amount of risk in specific trading activities and determines our tolerance for such activities. Management monitors risks in its trading activities by establishing limits for the trading desk and reviewing daily trading results, inventory aging, and securities concentrations. Typically, market conditions are evaluated and transaction details and securities positions are reviewed. These activities seek to ensure that trading strategies are within acceptable risk tolerance parameters. Activities include price verification procedures, position reconciliations and reviews of transaction bookings. We believe these procedures, which stress timely communications between traders, trading management and senior management, are important elements of the risk management process.

#### *Equity Price Risk*

Equity price risk represents the potential loss in value due to adverse changes in the level or volatility of equity prices. We are exposed to equity price risk through our trading activities in both listed and OTC equity markets and security positions in our principal investment portfolio. We attempt to reduce the risk of loss inherent in our inventory of equity securities by establishing position limits, monitoring inventory turnover and entering into hedging transactions designed to mitigate our market risk profile.

Our marketable securities owned include long positions in equity securities that were recorded at a fair value of \$14.2 million as of September 30, 2007. Our marketable securities sold but not yet purchased consist of short positions in equity securities and were recorded at a fair value of \$9.3 million as of September 30, 2007. The net potential loss in fair value for our marketable equity securities portfolio as of September 30, 2007, using a hypothetical 10% decline in prices, is estimated to be approximately \$0.5 million. In addition, as of September 30, 2007, we have invested \$31.0 million of our own capital in our funds, which are invested primarily in publicly traded equity securities. The net potential loss in fair value for our investments at September 30, 2007, using a hypothetical 10% decline in the funds' investment portfolios, is estimated to be approximately \$3.1 million.

#### *Interest Rate Risk*

Interest rate risk represents the potential loss from adverse changes in market interest rates. As we may hold U.S. Treasury securities and other fixed income securities and may incur interest-sensitive liabilities from time to time, we are exposed to interest rate risk arising from changes in the level and volatility of interest rates and in the shape of the yield curve.

#### *Credit Risk*

Our broker-dealer subsidiary places and executes customer orders. The orders are then settled by an unrelated clearing organization that maintains custody of customers' securities and provides financing to customers.

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Through indemnification provisions in our agreement with our clearing organization, customer activities may expose us to off-balance-sheet credit risk. We may be required to purchase or sell financial instruments at prevailing market prices in the event a customer fails to settle a trade on its original terms or in the event cash and securities in customer margin accounts are not sufficient to fully cover customer obligations. We seek to control the risks associated with brokerage services for our customers through customer screening and selection procedures as well as through requirements that customers maintain margin collateral in compliance with governmental and self-regulatory organization regulations and clearing organization policies.

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### *Inflation Risk*

Because our assets are generally liquid in nature, they are not significantly affected by inflation. However, the rate of inflation affects such expenses as employee compensation and communications charges, which may not be readily recoverable in the prices of services we offer. To the extent inflation results in rising interest rates and has other adverse effects on the securities markets, it may adversely affect our combined financial condition and results of operations in certain businesses.

### **Critical Accounting Policies and Estimates**

The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and of revenues and expenses during the reporting periods. We base our estimates and assumptions on historical experience and on various other factors that we believe are reasonable under the circumstances. The use of different estimates and assumptions could produce materially different results. For example, if factors such as those described in *Risk Factors* cause actual events to differ from the assumptions we used in applying the accounting policies, our results of operations, financial condition and liquidity could be adversely affected.

Our significant accounting policies are summarized in Note 2 to our consolidated financial statements included elsewhere in this report. On an ongoing basis, we evaluate our estimates and assumptions, particularly as they relate to accounting policies that we believe are most important to the presentation of our financial condition and results of operations. We regard an accounting estimate or assumption to be most important to the presentation of our financial condition and results of operations where:

the nature of the estimate or assumption is material due to the level of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and

the impact of the estimate or assumption on our financial condition or operating performance is material.

Using the foregoing criteria, we consider the following to be our critical accounting policies:

### *Valuation of Financial Instruments*

Substantially all of our financial instruments are recorded at fair value or contract amounts that approximate fair value. The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Marketable securities owned, other investments including warrant positions and investments in partnerships in which JMP Asset Management is the general partner and Marketable securities sold, but not yet purchased, are stated at fair value, with related changes in unrealized appreciation or depreciation reflected in the line item *principal transactions* in our Consolidated Statements of Net Income (Loss).

As of September 30, 2007, the total of our financial instruments recorded at fair value, or contract amounts that approximate fair value, was \$62.3 million. Fair values for these instruments were determined using either: 1) Quoted market prices or broker or dealer price quotations, which involve no subjective judgment on the part of management, 2) the Black-Scholes options valuation model, or 3) for Other Investments, the fair values of the underlying investments which are determined by third party general partners. Accordingly, we do not exercise discretion in determining the fair value of our other investments. Because many of the securities in the portfolios of these funds may trade infrequently or are non-marketable securities and, therefore, do not have readily determinable fair values, the third party general partner estimates the fair value of these securities using various pricing models and the information available. Among the factors that they consider in determining the fair value of the underlying financial instruments are discounted anticipated cash flows, the cost, terms and liquidity of the instrument, the financial condition, operating results and credit ratings of the issuer or underlying company, the quoted market price of publicly traded securities with similar duration and yield and other factors generally pertinent to the valuation of financial instruments.

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The following tables summarize our marketable securities and other investments, as presented in our Consolidated Statements of Financial Condition, by valuation methodology as of September 30, 2007:

|                                     | Marketable Securities Owned, at Market Value(1) | Marketable Securities Sold, But Not Yet Purchased, at Market Value (2) | Other Investments (3) |                 |                        |            | Total Other Investments | Total Marketable Securities and Other Investments |
|-------------------------------------|---|--|-----------------------|-----------------|------------------------|------------|-------------------------|---|
|                                     |   |  | General Partner       | General Partner | in Private Equity Fund | Warrants   |                         |   |
| <b>Fair values based on:</b>        |   |  |                       |                 |                        |            |                         |   |
| Quoted market prices                | \$ 23,862,441                                   | \$ 9,315,040   | \$ 22,181,774         | \$              | \$                     | \$         | \$ 22,181,774           | \$ 55,359,255                                     |
| Black Scholes Options Valuation     |   |  |                       |                 |                        | 379,199    | 379,199                 | 379,199   |
| Valuation determined by third party |   |  |                       |                 |                        |            |                         |   |
| General Partners                    |   |  |                       | 4,250,483       | 2,338,157              |            | 6,588,640               | 6,588,640   |
| Totals                              | \$ 23,862,441                                   | \$ 9,315,040   | \$ 22,181,774         | \$ 4,250,483    | \$ 2,338,157           | \$ 379,199 | \$ 29,149,613           | \$ 62,327,094                                     |
| <b>Fair values based on:</b>        |   |  |                       |                 |                        |            |                         |   |
| Quoted market prices                | 100.0%  | 100.0%   | 76.1%                 |                 |                        |            | 76.1%                   | 88.8%   |
| Black Scholes Options Valuation     |   |  |                       |                 |                        | 1.3%       | 1.3%                    | 0.6%  |
| Valuation determined by third party |   |  |                       |                 |                        |            |                         |   |
| General Partners                    |   |  |                       | 14.6%           | 8.0%                   |            | 22.6%                   | 10.6%   |
| Totals                              | 100.0%  | 100.0%   | 76.1%                 | 14.6%           | 8.0%                   | 1.3%       | 100.0%                  | 100.0%  |

- (1) Marketable securities owned consist mainly of U.S. listed and OTC equity securities, as well as quasi-government agency securities.
- (2) Marketable securities sold, but not yet purchased consist mainly of U.S. listed and OTC equity securities.
- (3) Other investments consist of general partnership interests in funds and funds of hedge funds managed by JMP Asset Management, limited partnership interests in private investment funds managed by third parties that invest in predominately private securities and warrants in public and private common stock.

*Asset Management Investment Partnerships*

Investments in partnerships include our general partnership interests in investment partnerships. Such investments are held by our asset management subsidiary and are accounted for under the equity method based on our proportionate share of the earnings (or losses) of the investment partnership. In accordance with the AICPA Audit and Accounting Guide for investment companies, these interests are carried at estimated fair value based on our capital accounts in the underlying partnerships. The net assets of the investment partnerships consist primarily of investments in marketable and non-marketable securities. The underlying investments held by such partnerships are valued based on quoted market prices or estimated fair value if there is no public market. Such estimates of fair value of the partnerships non-marketable investments are ultimately determined by our affiliates in their capacity as general partner. Due to the inherent uncertainty of valuation, fair values of these non-marketable investments may differ from the values that would have been used had a ready market existed for these investments, and the differences could be material. Adjustments to carrying value are made, if required by GAAP, if there are third-party transactions evidencing a change in value. Downward adjustments are also made, in the absence of third-party transactions, if the general partner determines that the expected realizable value of the investment is less than the carrying value.

We earn base management fees from the investment partnerships that we manage generally based on the net assets of the underlying partnerships. In addition, we are entitled to allocations of the appreciation and depreciation in the fair value of the underlying partnerships from our general partnership interests in the partnerships. Such allocations are based on the terms of the respective partnership agreements.

We are also entitled to receive incentive fee allocations from the investment partnerships when the return exceeds certain threshold returns. Incentive fees are recorded after the quarterly or annual investment performance period is complete and may vary depending on the terms of the

fee structure applicable to an investor.

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### *Legal and Other Contingent Liabilities*

We are involved in various pending and potential complaints, arbitrations, legal actions, investigations and proceedings related to our business from time to time. Some of these matters involve claims for substantial amounts, including claims for punitive and other special damages. The number of complaints, legal actions, investigations and regulatory proceedings against financial institutions like us has been increasing in recent years. We have, after consultation with counsel and consideration of facts currently known by management, recorded estimated losses in accordance with SFAS 5, *Accounting for Contingencies*, to the extent that a claim may result in a probable loss and the amount of the loss can be reasonably estimated. The determination of these reserve amounts requires significant judgment on the part of management and our ultimate liabilities may be materially different. In making these determinations, management considers many factors, including, but not limited to, the loss and damages sought by the plaintiff or claimant, the basis and validity of the claim, the likelihood of successful defense against the claim and the potential for, and magnitude of, damages or settlements from such pending and potential complaints, legal actions, arbitrations, investigations and proceedings, and fines and penalties or orders from regulatory agencies.

If a potential adverse contingency should become probable or resolved for an amount in excess of the established reserves during any period, our results of operations in that period and, in some cases, succeeding periods, could be adversely affected.

### **ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

Quantitative and qualitative disclosures about market risk are set forth under the caption **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** **Quantitative and Qualitative Disclosures About Market Risk**.

### **ITEM 4. Controls and Procedures**

Our management, with the participation of the Chairman and Chief Executive Officer and the Chief Financial Officer (our principal executive officer and principal financial officer, respectively), evaluated our disclosure controls and procedures as of the end of the period covered by this report.

Based on that evaluation, our Chairman and Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the Chairman and Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1. Legal Proceedings**

We are involved in a number of judicial, regulatory and arbitration matters arising in connection with our business. The outcome of matters we are involved in cannot be determined at this time, and the results cannot be predicted with certainty. There can be no assurance that these matters will not have a material adverse effect on our results of operations in any future period and a significant judgment could have a material adverse impact on our financial condition, results of operations and cash flows. We may in the future become involved in additional litigation in the ordinary course of our business, including litigation that could be material to our business. However, we do not believe that we have any material legal or regulatory proceedings currently pending or threatened against us.

In accordance with SFAS No. 5, *Accounting for Contingencies*, we review the need for any loss contingency reserves and establish reserves when, in the opinion of management, it is probable that a matter would result in liability and the amount of loss, if any, can be reasonably estimated. Generally, with respect to matters we are involved in, in view of the inherent difficulty of predicting the outcome of these matters, particularly in cases in which claimants seek substantial or indeterminate damages, it is not possible to determine whether a liability has been



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incurred or to reasonably estimate the ultimate or minimum amount of that liability until the case is close to resolution, in which case no reserve is established until that time.

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**ITEM 1A. Risk Factors**

The risk factors included in our Registration Statement on Form S-1 (Commission File No. 333-140689) continue to apply to us, and describe risks and uncertainties that could cause actual results to differ materially from the results expressed or implied by the forward-looking statements contained in this Quarterly Report. There have not been any material changes from the risk factors previously described in our Registration Statement on Form S-1.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

**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**

See Exhibit Index.

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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.

Date: November 7, 2007

JMP Group Inc.

By: /s/ Joseph A. Jolson  
Name: Joseph A. Jolson  
Title: Chairman and Chief Executive Officer

By: /s/ Thomas B. Kilian  
Name: Thomas B. Kilian  
Title: Chief Financial Officer

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**EXHIBIT INDEX**

**Exhibit**

| <b>Number</b> | <b>Description</b>  |
|---------------|---|
| 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 Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2          | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |