

OPPENHEIMER HOLDINGS INC  
Form 10-Q  
November 08, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

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

For the Quarterly Period ended **September 30, 2006**

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: 1-12043

**OPPENHEIMER HOLDINGS INC.**

(Exact name of registrant as specified in its charter)

Canada

98-0080034

(State or other jurisdiction of

(I.R.S. Employer

incorporation or organization)

Identification No.)

P.O. Box 2015, Suite 1110

20 Eglinton Avenue West

Toronto, Ontario, Canada M4R 1K8

(Address of principal executive offices)

(Zip Code)

416-322-1515

(Registrant's telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether 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 ☐

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Indicate by a 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 Company's Class A non-voting shares and Class B voting shares (being the only classes of common stock of the Company) outstanding on November 3, 2006 was 12,771,720 and 99,680 shares, respectively.

OPPENHEIMER HOLDINGS INC.

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**PART 1**  
**FINANCIAL INFORMATION**

**Item. 1 Financial Statements**

OPPENHEIMER HOLDINGS INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

|   | September<br>30,<br>2006 | December 31,<br>2005 |
|---|--------------------------|----------------------|
| <i>Expressed in thousands of U.S. dollars</i>   |                          |                      |
| <b>ASSETS</b>   |                          |                      |
| Cash and cash equivalents   | \$18,199                 | \$32,013             |
| Cash and securities segregated under federal and<br>other regulations                       | 40,142                   | 23,526               |
| Deposits with clearing organizations  | 12,228                   | 14,240               |
| Receivable from brokers and clearing<br>organizations                                       | 492,242                  | 527,490              |
| Receivable from customers   | 1,015,917                | 1,117,214            |
| Securities owned including amounts pledged of \$1,592<br>(\$1,042 in 2005), at market value | 126,504                  | 146,645              |
| Notes receivable  | 53,756                   | 59,874               |
| Property, plant and equipment, net  | 16,416                   | 18,787               |
| Intangible assets, net of amortization  | 33,844                   | 34,395               |
| Goodwill  | 137,889                  | 137,889              |
| Other   | 60,369                   | 72,394               |
|   | <b>\$2,007,506</b>       | <b>\$2,184,467</b>   |

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

OPPENHEIMER HOLDINGS INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS (unaudited)

September 30,    December 31,  
2006                      2005

*Expressed in thousands of U.S. dollars*

**LIABILITIES AND SHAREHOLDERS' EQUITY**

**Liabilities**

|   |           |           |
|---|-----------|-----------|
| Drafts payable  | \$42,815  | \$46,012  |
| Bank call loans   | 70,377    | 139,700   |
| Payable to brokers and clearing organizations           | 871,375   | 830,478   |
| Payable to customers                                    | 325,465   | 473,212   |
| Securities sold, but not yet purchased, at market value | 11,949    | 9,786     |
| Accrued compensation                                    | 86,786    | 87,040    |
| Accounts payable and other liabilities                  | 78,677    | 80,811    |
| Income taxes payable                                    | 7,095     | 6,584     |
| Bank loans  | -         | 14,524    |
| Zero coupon promissory note                             | 16,356    | 22,822    |
| Exchangeable debentures                                 | 20,000    | 160,822   |
| Senior secured credit note                              | 124,688   | -         |
| Deferred income tax, net                                | 5,998     | 4,553     |
|   | 1,661,581 | 1,876,344 |

**Shareholders' equity**

**Share capital**

12,712,522 Class A non-voting shares

(2005 12,496,141 shares)

37,782                      32,498

99,680 Class B voting shares

133                      133

37,915                      32,631

Contributed capital

11,119                      8,810

Retained earnings

296,891                      266,682

345,925                      308,123

\$2,007,506                      \$2,184,467



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

OPPENHEIMER HOLDINGS INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)

|   | Three months ended |          | Nine months ended |           |
|---|--------------------|----------|-------------------|-----------|
|   | September 30,      |          | September 30,     |           |
|   | 2006               | 2005     | 2006              | 2005      |
| Expressed in thousands of dollars, except per share amounts |                    |          |                   |           |
| REVENUE:  |                    |          |                   |           |
| Commissions   | \$85,101           | \$81,648 | \$268,545         | \$237,948 |
| Principal transactions, net                                 | 28,197             | 25,353   | 86,453            | 71,591    |
| Interest  | 27,349             | 20,926   | 80,907            | 53,069    |
| Investment banking  | 11,391             | 11,638   | 36,021            | 38,450    |
| Advisory fees   | 27,628             | 27,029   | 81,780            | 82,778    |
| Other   | 8,797              | 4,668    | 28,831            | 10,601    |
|   | 188,463            | 171,262  | 582,537           | 494,437   |
| EXPENSES:   |                    |          |                   |           |
| Compensation and related expenses                           | 112,148            | 104,441  | 340,902           | 309,752   |
| Clearing and exchange fees                                  | 4,113              | 4,079    | 12,458            | 12,695    |
| Communications and technology                               | 13,875             | 12,894   | 39,719            | 38,449    |
| Occupancy and equipment costs                               | 12,984             | 12,291   | 38,096            | 35,886    |
| Interest  | 17,032             | 11,474   | 47,651            | 27,085    |
| Other   | 15,037             | 14,643   | 45,231            | 44,096    |
|   | 175,189            | 159,822  | 524,057           | 467,963   |
| Profit before income taxes                                  | 13,274             | 11,440   | 58,480            | 26,474    |
| Income tax provision  | 5,601              | 4,822    | 24,453            | 11,296    |
| NET PROFIT FOR THE PERIOD                                   | \$7,673            | \$6,618  | \$34,027          | \$15,178  |
| Earnings per share:   |                    |          |                   |           |
| Basic   | \$0.60             | \$0.51   | \$2.66            | \$1.16    |
| Diluted   | \$0.51             | \$0.38   | \$1.99            | \$0.91    |
| Dividends declared per share                                | \$0.10             | \$0.09   | \$0.30            | \$0.27    |

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

OPPENHEIMER HOLDINGS INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

|  | Three Months ended |          | Nine Months ended |           |
|--|--------------------|----------|-------------------|-----------|
|  | September 30,      |          | September 30,     |           |
|  | 2006               | 2005     | 2006              | 2005      |
| Expressed in thousands of dollars                                  |                    |          |                   |           |
| Cash flows from operating activities:                              |                    |          |                   |           |
| Net profit for the period  | \$7,673            | \$6,618  | \$34,027          | \$15,178  |
| Adjustments to reconcile net profit to net cash provided           |                    |          |                   |           |
| by (used in) operating activities:                                 |                    |          |                   |           |
| Non-cash items included in net profit:                             |                    |          |                   |           |
| Depreciation and amortization                                      | 2,635              | 2,750    | 7,469             | 7,591     |
| Deferred income tax  | (6,167)            | (9,976)  | 1,445             | (5,452)   |
| Tax benefit from employee stock options exercised                  | -                  | -        | -                 | 30        |
| Amortization of notes receivable                                   | 5,159              | 5,754    | 15,720            | 17,655    |
| Amortization of debt issuance costs                                | 139                | -        | 139               | -         |
| Change in allowance for doubtful accounts                          | 30                 | 6        | (227)             | (1,076)   |
| Stock option expense, net  | 533                | -        | 2,153             | -         |
| Decrease (increase) in operating assets:                           |                    |          |                   |           |
| Cash and securities segregated under federal and other regulations | (8,011)            | (2,790)  | (16,616)          | (7,829)   |
| Deposits with clearing organizations                               | 1,507              | 438      | 2,012             | 4,004     |
| Receivable from brokers and clearing organizations                 | 72,078             | 56,598   | 35,248            | (5,075)   |
| Receivable from customers  | 149,065            | 42,309   | 101,524           | (232,473) |
| Securities owned   | 6,674              | (43,030) | 20,141            | (41,845)  |
| Notes receivable   | (2,068)            | (3,458)  | (9,602)           | (6,154)   |
| Other assets   | 854                | (9,573)  | 15,921            | (7,947)   |
| Increase (decrease) in operating liabilities:                      |                    |          |                   |           |
| Drafts Payable   | (3,019)            | (2,906)  | (3,197)           | (17,887)  |
|  | (156,887)          | 90,349   | 40,897            | 206,934   |

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|   |          |          |           |           |
|---|----------|----------|-----------|-----------|
| Payable to brokers and clearing organizations   |          |          |           |           |
| Payable to customers                            | (31,041) | (51,161) | (147,747) | (63,209)  |
| Securities sold, but not yet purchased          | 3,039    | 4,235    | 2,163     | 4,412     |
| Accrued compensation                            | 16,014   | 9,424    | (254)     | (2,693)   |
| Accounts payable and other liabilities          | 25       | 15,547   | (2,134)   | 20,032    |
| Income taxes payable                            | 1,697    | 4,076    | 511       | 1,694     |
| Cash provided by (used in) operating activities | 59,929   | 115,210  | 99,593    | (114,110) |
| Cash flows from investing and other activities: |          |          |           |           |
| Purchase of fixed assets                        | (2,440)  | (1,341)  | (4,547)   | (3,080)   |
| Cash used in investing and other activities     | (2,440)  | (1,341)  | (4,547)   | (3,080)   |

OPPENHEIMER HOLDINGS INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED

|  | Three Months ended |           | Nine Months ended |          |
|--|--------------------|-----------|-------------------|----------|
|  | September 30,      |           | September 30,     |          |
|  | 2006               | 2005      | 2006              | 2005     |
| Cash flows from financing activities:                        |                    |           |                   |          |
| Cash dividends paid on Class A non-voting and Class B shares | (1,277)            | (1,162)   | (3,818)           | (3,558)  |
| Issuance of Class A non-voting shares                        | 1,965              | -         | 7,539             | 2,629    |
| Tax benefit from employee stock options exercised            | 111                | -         | 156               | -        |
| Repurchase of Class A non-voting shares for cancellation     | -                  | (6,451)   | (2,255)           | (16,948) |
| Issue of senior secured credit note                          | 125,000            | -         | 125,000           | -        |
| Senior secured credit note repayments                        | (312)              | -         | (312)             | -        |
| Debt issuance costs  | (4,035)            | -         | (4,035)           | -        |
| Redemption of variable rate exchangeable debentures          | (140,822)          | -         | (140,822)         | -        |
| Zero coupon promissory note repayments                       | (1,997)            | (3,095)   | (6,466)           | (9,978)  |
| Bank loan repayments   | -                  | (2,530)   | (14,524)          | (7,590)  |
| (Decrease) increase in bank call loans                       | (45,523)           | (90,500)  | (69,323)          | 170,027  |
| Cash (used in) provided by financing activities              | (66,890)           | (103,738) | (108,860)         | 134,582  |
| Net (decrease) increase in cash and cash equivalents         | (9,401)            | 10,131    | (13,814)          | 17,392   |
| Cash and cash equivalents, beginning of period               | 27,600             | 40,651    | 32,013            | 33,390   |
| Cash and cash equivalents, end of period                     | \$18,199           | \$50,782  | \$18,199          | \$50,782 |

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



OPPENHEIMER HOLDINGS INC.  
 CONDENSED CONSOLIDATED STATEMENTS OF  
 CHANGES IN SHAREHOLDERS' EQUITY (unaudited)

|  | Three Months ended |           | Nine Months ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | September 30,      |           | September 30,     |           |
|  | 2006               | 2005      | 2006              | 2005      |
| Expressed in thousands of dollars                        |                    |           |                   |           |
| <b>Share capital</b>                                     |                    |           |                   |           |
| Balance at beginning of period                           | \$35,950           | \$41,769  | \$32,631          | \$49,637  |
| Issue of Class A non-voting shares                       | 1,965              | -         | 7,539             | 2,629     |
| Repurchase of Class A non-voting shares for cancellation | -                  | (6,451)   | (2,255)           | (16,948)  |
| Balance at end of period                                 | \$37,915           | \$35,318  | \$37,915          | \$35,318  |
| <b>Contributed capital</b>                               |                    |           |                   |           |
| Balance at beginning of period                           | \$10,475           | \$8,810   | \$8,810           | \$8,780   |
| Tax benefit from employee stock options exercised        | 111                | -         | 156               | 30        |
| Stock option expense                                     | 733                | -         | 2,699             | -         |
| Deferred tax benefit from stock option expense           | (200)              | -         | (546)             | -         |
| Balance at end of period                                 | \$11,119           | \$8,810   | \$11,119          | \$8,810   |
| <b>Retained earnings</b>                                 |                    |           |                   |           |
| Balance at beginning of period                           | \$290,495          | \$254,631 | \$266,682         | \$248,467 |
| Net profit for the period                                | 7,673              | 6,618     | 34,027            | 15,178    |
| Dividends of \$0.10 per share (\$0.09 per share in 2005) | (1,277)            | (1,162)   | (3,818)           | (3,558)   |
| Balance at end of period                                 | \$296,891          | \$260,087 | \$296,891         | \$260,087 |



|                               |           |           |           |           |
|-------------------------------|-----------|-----------|-----------|-----------|
| TOTAL SHAREHOLDERS'<br>EQUITY | \$345,925 | \$304,215 | \$345,925 | \$304,215 |
|-------------------------------|-----------|-----------|-----------|-----------|

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

OPPENHEIMER HOLDINGS INC.

Notes to Condensed Consolidated Financial Statements (Unaudited)

**1. Summary of significant accounting policies**

The condensed consolidated financial statements include the accounts of Oppenheimer Holdings Inc. ( OPY ) and its subsidiaries (together, the Company ). The principal subsidiaries of OPY are Oppenheimer & Co. Inc. ( Oppenheimer ), a registered broker-dealer in securities, and Oppenheimer Asset Management Inc. ( OAM ), a registered investment advisor under the Investment Advisers Act of 1940. Oppenheimer operates as Fahnstock & Co. Inc. in Latin America. Oppenheimer owns Freedom Investments, Inc. ( Freedom ), a registered broker dealer in securities, which operates its BUYandHOLD division, offering online discount brokerage and dollar-based investing services. The Company engages in a broad range of activities in the securities industry, including retail securities brokerage, institutional sales and trading, investment banking (both corporate and public finance), research, market-making, securities lending activities, trust services and investment advisory and asset management services.

The Company s condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). These accounting principles are set out in the notes to the Company s consolidated financial statements for the year ended December 31, 2005 included in its Annual Report on Form 10-K for the year ended December 31, 2005, except for new policies set out below.

*Interest Rate Swaps*

On September 29, 2006, the Company entered into interest rate swap transactions to hedge the interest payments associated with the floating rate senior secured credit note, which is subject to change due to changes in 3-Month LIBOR. These swaps have been designated as cash flow hedges under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities . Changes in the fair value of the swap hedges are expected to be highly effective in offsetting changes in the interest payments due to changes in 3-Month LIBOR.

*Debt Issuance costs*

Debt issuance costs, included in other assets, from the issuance of the senior secured credit notes are reported in the condensed consolidated balance sheet as deferred charges and amortized using the interest method. Debt issuance costs include underwriting and legal fees as well as other incremental expenses directly attributable to realizing the proceeds of the senior secured credit note issued.

Disclosures reflected in these condensed consolidated financial statements comply in all material respects with those required pursuant to the rules and regulations of the United States Securities and Exchange Commission ( SEC ) with respect to quarterly financial reporting.

The condensed consolidated financial statements include all adjustments, which in the opinion of management are normal and recurring and necessary for a fair statement of the results of operations, financial position and cash flows for the interim periods presented. The nature of the Company s business is such that the results of operations for the interim periods are not necessarily indicative

of the results to be expected for a full year.

These condensed consolidated financial statements are presented in U.S. dollars.

## **2. Recent Accounting Pronouncements**

### *Recently adopted*

In June 2005, the FASB ratified the consensus reached in Emerging Issues Task Force ( EITF ) Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* which requires a general partner(s) (or managing member(s) in the case of limited liability companies) to consolidate its partnerships or to provide limited partners with rights to remove the general partner(s) or to terminate the partnership. The Company serves as a general partner for a number of asset management limited partnerships through OAM and, therefore, was required to adopt the provisions of EITF Issue No. 04-5 immediately for partnerships formed or modified after June 29, 2005. For partnerships formed on or before June 29, 2005 that were not

modified, the Company was required to adopt EITF 04-5 on January 1, 2006. The adoption of EITF Issue No. 04-5 did not have a material impact on the Company's condensed consolidated financial statements.

*Recently Issued*

In June 2006, the FASB issued Interpretation 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation requires that a tax position be recognized only if it is more likely than not to be sustained upon examination, including resolution of related appeals or litigation processes, based solely on its technical merits, as of the reporting date. A tax position that meets the more-likely-than-not criterion shall be measured at the largest amount of benefit that is more than 50 percent likely of being realized upon ultimate settlement. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact this guidance will have on the condensed consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 ( SFAS 157 ), *Fair Value Measurements*, which provides expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value and does not expand the use of fair value in any new circumstances. In addition, SFAS No. 157 prohibits recognition of block discounts for large holdings of unrestricted financial instruments where quoted prices are readily and regularly available in an active market. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years with early adoption permitted. The Company is currently evaluating the impact this guidance will have on the condensed consolidated financial statements.

### **3. Earnings per share**

Earnings per share was computed by dividing net profit by the weighted average number of Class A non-voting shares ( Class A Shares ) and Class B voting shares ( Class B Shares ) outstanding. Diluted earnings per share includes the weighted average Class A and Class B Shares outstanding and the effects of exchangeable debentures using the if converted method and Class A Shares granted under share-based compensation arrangements using the treasury stock method.



Earnings per share has been calculated as follows:

| In thousands of dollars, except<br>share and per share amounts      | Three Months ended |            | Nine Months ended |            |
|---|--------------------|------------|-------------------|------------|
|   | September 30,      |            | September 30,     |            |
|   | 2006               | 2005       | 2006              | 2005       |
| Basic weighted average number of<br>shares outstanding              | 12,784,096         | 13,100,893 | 12,810,492        | 13,139,712 |
| Net effect, if converted method (1)                                 | 2,907,372          | 6,932,000  | 5,575,715         | 6,932,000  |
| Net effect, treasury method (2)                                     | 81,731             | -          | 25,996            | 278        |
| Diluted common shares   | 15,773,199         | 20,032,893 | 18,412,204        | 20,071,990 |
| Net profit for the period, as<br>reported                           | \$7,673            | \$6,618    | \$34,027          | \$15,178   |
| Effect of dilutive exchangeable<br>debentures                       | 416                | 1,071      | 2,543             | 3,183      |
| Net profit, available to<br>shareholders and assumed<br>conversions | \$8,089            | \$7,689    | \$36,570          | \$18,361   |
| Basic earnings per share  | \$0.60             | \$0.51     | \$2.66            | \$1.16     |
| Diluted earnings per share  | \$0.51             | \$0.38     | \$1.99            | \$0.91     |

(1)

As part of the consideration for the 2003 acquisition of the Oppenheimer divisions from CIBC World Markets, the Company issued First and Second Variable Rate Exchangeable Debentures which, until July 31, 2006, were exchangeable for approximately 6.9 million Class A Shares of the Company at the rate of \$23.20 per share (approximately 35% of the outstanding Class A Shares, if exchanged). On July 31, 2006, the Company redeemed all but \$20 million of such debentures, which were exchangeable for 862,069 Class A Shares of the Company at the rate of \$23.20 per share (approximately 6% of the outstanding Class A Shares, if exchanged).

(2)



The diluted EPS computations do not include the antidilutive effect of Class A Shares granted under share-based compensation arrangements.

|  | Three Months ended    |                       | Nine Months ended     |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 30,<br>2006 | September 30,<br>2005 | September 30,<br>2006 | September 30,<br>2005 |
| Number of anti-dilutive options and restricted shares, end of period | 672,724               | 1,776,141             | 1,196,694             | 1,746,975             |

**4. Securities owned and securities sold, but not yet purchased (at market value)**

|  | September 30,<br>2006 | December 31,<br>2005 |
|--|-----------------------|----------------------|
| Securities owned consist of:   |                       |                      |
| Corporate equities and warrants  | \$39,714,000          | \$35,895,000         |
| Corporate and sovereign obligations  | 44,272,000            | 46,482,000           |
| U.S. government and agency and state and<br>municipal government obligations | 41,175,000            | 61,590,000           |
| Money market funds and other   | 1,343,000             | 2,678,000            |
|  | \$126,504,000         | \$146,645,000        |

|  | September 30,<br>2006 | December 31,<br>2005 |
|--|-----------------------|----------------------|
| Securities sold, but not yet purchased consist of:                                     |                       |                      |
| Corporate equities   | \$6,108,000           | \$4,685,000          |
| Corporate obligations  | 3,589,000             | 3,722,000            |
| U.S. government and agency and state and<br>municipal government obligations and other | 2,252,000             | 1,379,000            |
|  | \$11,949,000          | \$9,786,000          |

Securities owned and securities sold, but not yet purchased, consist of trading and investment securities at market and fair values. Included in securities owned at September 30, 2006 are corporate equities with market values of approximately \$14,514,000 (\$14,660,000 at December 31, 2005), which are correlated to deferred compensation liabilities to certain employees. Also included in corporate equities in securities owned are investments with estimated fair values of approximately \$7.2 million, of which approximately \$4.7 million relates to restricted shares of NYSE Group. At September 30, 2006, the Company had pledged securities owned of approximately \$1,592,000 (\$1,042,000 at December 31, 2005) as collateral to counterparties for stock loan transactions, which can be sold or repledged.

The New York Stock Exchange ( NYSE )/Archipelago merger (collectively referred to as NYSE Group ), which took place in March 2006, had a significant impact on the Company's financial results for the nine months ended September 30, 2006. Oppenheimer had been a member of the NYSE since 1880 and was the beneficial owner of three memberships (seats) carried at a cost of \$2.2 million. Pursuant to the plan of merger between NYSE and Archipelago, Oppenheimer surrendered its memberships in exchange for approximately \$809,000 in cash and 241,901 NYSE Group common shares, par value \$0.01 per share, in the aggregate. In lieu of the rights conferred by membership, Oppenheimer purchased the rights to an annual renewable trading license. This license allows Oppenheimer continued physical and electronic access to the NYSE trading facilities. The NYSE Group common shares are subject to a three-year restriction on transfer, which were scheduled to expire in equal one-third installments in March 2007, 2008, and 2009.



On May 4, 2006, the Company sold 156,588 shares of NYSE Group (consisting of 80,635 and 75,953 NYSE Group shares that were originally restricted until March 2007 and March 2008, respectively) at a price of \$61.50 per share (before commission) as part of a secondary offering by NYSE Group shareholders. The Company's pre-tax profit for the three and nine months ended September 30, 2006 reflect a net gain of \$782,000 and \$12,401,000, respectively, related to the exchange of seats for cash and NYSE Group common shares.

**5. Long term debt**

| Issued  | Maturity Date | Interest Rate | September 30,<br>2006 |
|---|---------------|---------------|-----------------------|
| Zero Coupon Promissory Note,<br>issued January 2, 2003 (a)              | -             | 0%            | \$16,356,000          |
| Less current portion  |               |               | 4,661,000             |
| Long term portion of Zero Coupon<br>Promissory Note                     |               |               | <u>\$11,695,000</u>   |
| Senior Secured Credit Note (b)  | 7/31/2013     | 8.2%          | \$124,688,000         |
| Less current portion  |               |               | 1,250,000             |
| Long term portion of Senior<br>Secured Credit Note                      |               |               | \$123,438,000         |
| Variable Rate Exchangeable<br>Debentures, issued January 6, 2003<br>(c) | 1/2/2013      | 4.5%          | \$20,000,000          |

(a) The Zero Coupon Promissory Note is repayable as related employee notes receivable, which are assigned to Oppenheimer, become due or are forgiven. Such payments are to be made notwithstanding whether any of the employees' loans default.

(b) On July 31, 2006, the Company issued a senior secured credit note in the amount of \$125,000,000 at a variable interest rate based on the London Interbank Offering Rate (LIBOR) with a seven-year term to a syndicate led by Morgan Stanley Senior Funding Inc, as agent. Minimum principal repayments equal 0.25% per quarter and there are required prepayments of principal based on a portion of the Company's excess cash flow, the net cash proceeds of asset sales, tax refunds over certain limits, awards over certain limits in connection with legal actions or takings, and debt issuances or other liability financings. In accordance with the senior secured credit note, the Company has provided certain covenants to the lenders with respect to the maintenance of a minimum fixed charge ratio and maximum leverage ratio driven from EBITDA and minimum net capital requirements with respect to Oppenheimer. In the Company's view, the most restrictive of the covenants requires that the Company maintain a maximum leverage ratio of 2.30 (total long-term debt divided by EBITDA). At September 30, 2006, the Company was in compliance with the

covenants. The interest rate on the senior secured credit note for the two months ended September 30, 2006 was 8.2%. Interest expense for the two months ended September 30, 2006 was \$1,708,000.

The obligations under the Senior Secured Credit Note are guaranteed by certain of the Company's subsidiaries, other than broker-dealer subsidiaries, with certain exceptions, and are secured by a lien on substantially all of the assets of each guarantor, including a pledge of the ownership interests in each first-tier broker-dealer subsidiary held by a guarantor, with certain exceptions.

(c) On July 31, 2006, the Company bought back \$140,822,400 of its outstanding First and Second Variable Rate Exchangeable Debentures (the "Debentures") issued in 2003 to Canadian Imperial Bank of Commerce ("CIBC") at par plus accrued interest of \$485,055. The Debentures that were redeemed were exchangeable for approximately 6.1 million Class A Shares at the rate of \$23.20 per Class A Share. This leaves \$20 million of the Debentures outstanding, which are exchangeable for 862,069 Class Shares at the rate of \$23.20 per Class A Share. The annual interest rate is 3% in 2003, 4% in 2004 - 2006, and 5% in 2007 through maturity. The Debentures, which mature on January 2, 2013, contain a retraction clause, which may be activated by the holder for a period of 120 days at the end of year seven. Interest is payable semi-annually in June and December. Interest expense on the Debentures was \$733,000 and \$4,372,000, respectively, for the three and nine months ended September 30, 2006 (\$1,849,000 and \$5,488,000, respectively for the three and nine months ended September 30, 2005). Under the interest method, the effective annual interest rate over the life of the Debentures was 4.5%. See note 13.

The Company's pre-tax profit for the three and nine months ended September 30, 2006 includes a net gain of \$3.6 million on the extinguishment of \$140,822,400 of the Debentures on July 31, 2006. For the most part, this gain represents the difference between interest expensed by the Company since the issuance of the Debentures on January 6, 2003 at a 4.5% interest rate (the annual effective interest rate over the life of the Debentures) compared to the actual interest costs of 3% in 2003 and 4% until their redemption on July 31, 2006.

The Company has agreed to make a contingent payment to CIBC if, prior to December 31, 2007, the Company enters into an agreement for the sale of the majority of the Company's Class A and Class B Shares. The amount of the contingent payment would be based on the price per share realized by the Company's shareholders in any such transaction. The Company has made an estimate of the fair value of this contingent payment and will revalue it at the end of each reporting period.

## **6. Share-based compensation**

Effective January 1, 2006, the Company adopted SFAS No. 123-R, "Shares-Based Payment", which is a revision to SFAS No. 123, "Accounting for Stock-Based Compensation". SFAS No. 123-R, which requires that stock options be accounted for at fair value, focuses primarily on transactions in which an entity exchanges its equity instruments for employee services. Under SFAS No. 123-R, share-based compensation awards that require future service (ie. are subject to a vesting schedule) are amortized over the relevant service period. The Company adopted SFAS No. 123-R under the "modified prospective method". Under that method, the provisions of SFAS No. 123-R are applied to



remaining unvested share-based awards outstanding at December 31, 2005 as well as to share-based awards granted subsequent to adoption. The condensed consolidated financial statements for periods prior to adoption are not restated for the effects of adopting SFAS No. 123-R.

The Company estimates the fair value of share-based awards using the Black-Scholes option-pricing model and applies to it a forfeiture rate based on historical experience. The accuracy of this forfeiture rate will be reviewed at least annually for reasonableness. Key input assumptions used to estimate the fair value of share-based awards include the exercise price of the award, the expected term, the expected volatility of the Company's Class A Shares over the term of the award, the risk-free interest rate over the expected term, and the Company's expected annual dividend yield. The Company believes that the valuation technique and the approach utilized to develop the underlying assumptions are appropriate in calculating fair values of the Company's outstanding unvested share-based awards as of January 1, 2006 together with awards granted during the three and nine months ended September 30, 2006. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by persons who receive share-based awards.

The fair value of each award grant was estimated on the grant date using the Black-Scholes option-pricing model with the following assumptions:

|                                | Grant date assumptions |         |         |         |         |         |
|--------------------------------|------------------------|---------|---------|---------|---------|---------|
|                                | 2006                   | 2005    | 2004    | 2003    | 2002    | 2001    |
| Expected term (1)              | 5 years                | 5 years | 5 years | 5 years | 5 years | 5 years |
| Expected volatility factor (2) | 24.73%                 | 23.50%  | 21.08%  | 22.61%  | 27.49%  | 28.43%  |
| Risk-free interest rate (3)    | 4.48%                  | 3.89%   | 3.01%   | 2.92%   | 4.10%   | 4.78%   |
| Actual dividends (4)           | \$0.37                 | \$0.36  | \$0.36  | \$0.36  | \$0.36  | \$0.36  |

(1) The expected term was determined based on actual awards, typically five years.

(2) The volatility factor was measured using the weighted average of historical daily price changes of the Company's Class A Shares over the previous 100 days, using a 400 day annualization factor.

(3) The risk-free interest rate was based on periods equal to the expected term of the awards based on the U.S. Treasury yield curve in effect at the time of grant.

(4) Actual dividends were used to compute the expected annual dividend yield.

The Company did not recognize compensation expense for outstanding stock options during the three and nine months ended September 30, 2005. The following presents the pro forma income and earnings per share impact, using a fair-value-based calculation, of the Company's stock-based compensation under SFAS No. 123 with respect to stock options granted prior to January 1, 2006. Amounts are expressed in thousands of U.S. dollars except per share amounts.



|  | Three months<br>ended September<br>30, 2005 | Nine months<br>ended September<br>30, 2005 |
|--|---|--|
| Net profit, as reported  | \$6,618                                     | \$15,178                                   |
| Stock-based compensation expense that would have been reported in net profit if the fair value provisions of SFAS No. 123-R had been applied to all awards | 381   | 1,144                                      |
| Pro forma net profit   | \$6,237                                     | \$14,034                                   |
| Basic profit per share, as reported  | \$0.51                                      | \$1.16                                     |
| Diluted profit per share, as reported  | \$0.38                                      | \$0.91                                     |
| Pro forma basic profit per share   | \$0.48                                      | \$1.07                                     |
| Pro forma diluted profit per share   | \$0.36                                      | \$0.86                                     |

#### *Equity Incentive Plan*

Under the Company's 1996 Equity Incentive Plan, as amended March 10, 2005 ( "EIP" ), the compensation and stock option committee of the board of directors of the Company may grant options to purchase Class A Shares to officers and key employees of the Company and its subsidiaries. Grants of options are made to the Company's independent directors on a formula basis. Options are generally granted for a five-year term and generally vest at the rate of 25% of the amount granted beginning after two years and become fully vested after 4.5 years. The aggregate number of Class A Shares available under the EIP is 5,015,000.



Stock option activity under the EIP since January 1, 2005 is summarized as follows:

|  | Three months ended<br>September 30, 2006 |  | Nine months ended<br>September 30, 2006 |  | Year ended<br>December 31, 2005 |                                       |
|--|--|--|---|--|---------------------------------|---------------------------------------|
|  | Number of<br>shares                      | Weighted<br>average<br>exercise<br>price | Number of<br>shares                     | Weighted<br>average<br>exercise<br>price | Number of<br>shares             | Weighted<br>average<br>exercise price |
| Options outstanding,<br>beginning of period          | 1,408,622                                | \$27.59                                  | 1,775,641                               | \$27.04                                  | 1,659,370                       | \$27.19                               |
| Options granted                                      | -  | -  | 38,632                                  | \$21.70                                  | 231,798                         | \$23.38                               |
| Options exercised                                    | (79,130)                                 | \$24.83                                  | (161,915)                               | \$25.79                                  | (51,357)                        | \$19.48                               |
| Options forfeited or<br>expired                      | -  | -  | (322,866)                               | \$24.11                                  | (64,170)                        | \$20.93                               |
| Options outstanding,<br>end of period                | 1,329,492                                | \$27.75                                  | 1,329,492                               | \$27.75                                  | 1,775,641                       | \$27.04                               |
| Options vested, end<br>of period                     | 515,315                                  | \$27.61                                  | 515,315                                 | \$27.61                                  | 622,107                         | \$24.98                               |
| Weighted average<br>fair value of options<br>granted | -  | -  | -                                       | \$5.37                                   | -                               | -                                     |

The aggregate intrinsic value of options outstanding as of September 30, 2006 was approximately \$3,159,000. The intrinsic value of options vested as at September 30, 2006 was approximately \$1,048,000.

The following table summarizes stock options outstanding and exercisable as at September 30, 2006.

| Range of exercise prices | Number outstanding | Weighted average remaining contractual life | Weighted average exercise price of outstanding options | Number exercisable (vested) | Weighted average exercise price of vested options |
|--------------------------|--------------------|---|--|-----------------------------|---|
| \$19.99 - \$25.00        | 590,316            | 2.29 years                                  | \$23.49  | 176,718                     | \$23.67   |
| \$25.01 - \$33.80        | 739,176            | 1.85 years                                  | \$31.16  | 338,597                     | \$29.67   |
| \$19.99 - \$33.80        | 1,329,492          | 2.04 years                                  | \$27.75  | 515,315                     | \$27.61   |

The following table summarizes the status of the Company's non-vested options since December 31, 2005.

|                                | Three months ended September<br>30, 2006 |                                   | Nine months ended September<br>30, 2006 |                                   |
|--------------------------------|--|-----------------------------------|---|-----------------------------------|
|                                | Number of<br>Options                     | Weighted<br>average fair<br>value | Number of<br>Options                    | Weighted<br>average fair<br>value |
| Non-vested beginning of period | 843,343                                  | \$6.18                            | 1,153,534                               | \$5.44                            |
| Granted                        | -  | -                                 | 38,632                                  | \$5.37                            |
| Vested                         | (29,166)                                 | \$6.70                            | (349,729)                               | \$6.71                            |
| Forfeited or expired           | -  | -                                 | (28,260)                                | \$6.68                            |
| Non-vested end of period       | 814,177                                  | \$6.16                            | 814,177                                 | \$6.16                            |

In the three and nine months ended September 30, 2006, the Company has included approximately \$733,000 and \$2,699,000, respectively, of compensation expense in its condensed consolidated statement of operations relating to the expensing of stock options.

As of September 30, 2006, there was \$3.9 million of total unrecognized compensation cost related to unvested share-based compensation arrangements granted under the EIP. The cost is expected to be recognized over a weighted average period of 2.04 years.

### *Stock Appreciation Rights*

The Company has awarded Oppenheimer stock appreciation rights ( OARs ) to certain employees as part of their compensation package based on a formula reflecting gross production and length of service. These awards are granted once per year in January with respect to the prior year's production. The OARs vest five years from the end of the related fiscal year and will be settled in cash at vesting. Effective January 1, 2006, with the adoption of SFAS 123-R, OARs are being accounted for as liability awards and are being revalued on a monthly basis. The adjusted liability is being amortized on a straight-line basis over the vesting period.

The fair value of each OARs award was estimated as at September 30, 2006 using the Black-Scholes option-pricing model.



| Grant date                       | Number of<br>OARs | Strike price | R e m a i n i n g<br>contractual life | Fair value as at<br>September 30, 2006 |
|----------------------------------|-------------------|--------------|---------------------------------------|--|
| January 10, 2003                 | 109,630           | \$24.94      | 1.25 years                            | \$7.81                                 |
| January 13, 2004                 | 171,850           | \$32.78      | 2.25 years                            | \$6.86                                 |
| January 13, 2005                 | 276,320           | \$24.53      | 3.25 years                            | \$11.28                                |
| January 13, 2006                 | 292,020           | \$20.53      | 4.25 years                            | \$13.97                                |
| Total                            | 849,820           |              |                                       |  |
| Total weighted<br>average values |                   | \$24.88      | 3.13 years                            | \$10.86                                |

At September 30, 2006, all outstanding OARs were unvested. The aggregate intrinsic value of OARs outstanding at September 30, 2006 was \$3,733,000. In the three and nine months ended September 30, 2006, the Company included approximately \$651,000 and \$1,542,000, respectively, of compensation expense in its condensed consolidated statement of operations relating to OARs awards.

As of September 30, 2006, there was approximately \$5.3 million of total unrecognized compensation cost related to unvested OARs. The cost is expected to be recognized over a weighted average period of 3.13 years.

The adoption of SFAS No. 123-R did not materially impact the accounting treatment for the Company's other share-based compensation arrangements.

## 7. Share Capital

The following table reflects changes in the number of Class A Shares outstanding for the periods indicated:

|   | Three months ended    |                       | Nine months ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 30,<br>2006 | September 30,<br>2005 | September 30,<br>2006 | September 30,<br>2005 |
| Class A Shares outstanding, beginning of period       | 12,633,392            | 12,943,541            | 12,496,141            | 13,296,876            |
| Issued to Oppenheimer's 401(k) Plan                   | -                     | -                     | 104,725               | 64,176                |
| Issued pursuant to the share-based compensation plans | 79,130                | -                     | 222,356               | 51,357                |
| Repurchased and cancelled pursuant to the issuer bid  | -                     | (309,700)             | (110,700)             | (778,568)             |
| Class A Shares outstanding, end of period             | 12,712,522            | 12,633,841            | 12,712,522            | 12,633,841            |

## 8. Net Capital Requirements

The Company's major subsidiaries, Oppenheimer and Freedom, are subject to the uniform net capital requirements of the SEC under Rule 15c3-1 (the "Rule"). Oppenheimer computes its net capital requirements under the alternative method provided for in the Rule which requires that Oppenheimer maintain net capital equal to two percent of aggregate customer-related debit items, as defined in SEC Rule 15c3-3. At September 30, 2006, the net capital of Oppenheimer as calculated under the Rule was \$182,523,000 or 15.8 % of Oppenheimer's aggregate debit items. This was \$159,426,000 in excess of the minimum required net capital. Freedom computes its net capital requirement under the basic method provided for in the Rule, which requires that Freedom maintain net capital equal to the greater of \$250,000 or 6 2/3% of aggregate indebtedness, as defined. At September 30, 2006, Freedom had net capital of \$8,204,717, which was \$7,954,717 in excess of the \$250,000 required to be maintained at that date.



## 9. Collateralized transactions

The Company's customer financing and securities lending activities require the Company to pledge firm and customer securities as collateral for various financing sources such as securities lending and bank call loans.

The Company monitors the market value of collateral held and the market value of securities receivable from others. It is the Company's policy to request and obtain additional collateral when exposure to loss exists. In the event the counterparty is unable to meet its contractual obligation to return the securities, the Company may be exposed to off-balance sheet risk of acquiring securities at prevailing market prices.

### *Securities lending*

Securities borrowed and securities loaned are carried at the amounts of cash collateral advanced or received. Securities borrowed transactions require the Company to deposit cash or other collateral with the lender. The Company receives cash or collateral in an amount generally in excess of the market value of securities loaned. The Company monitors the market value of securities borrowed and loaned on a daily basis and may require counterparties to deposit additional collateral or return collateral pledged, when appropriate.

At September 30, 2006, included in receivable from brokers and clearing organizations are deposits paid for securities borrowed of \$441,425,000 (at December 31, 2005 - \$472,499,000). At September 30, 2006, included in payable to brokers and clearing organizations are deposits received for securities loaned of \$859,053,000 (at December 31, 2005 - \$794,353,000).

The Company has received collateral of approximately \$424,275,000 under securities borrow agreements of which the Company has repledged approximately \$331,650,000 as collateral under securities loans agreements. Included in receivable from brokers and clearing organizations are receivables from three major U.S. broker-dealers totaling \$186,850,000.

### *Bank call loans*

The Company obtains short-term borrowings primarily through bank call loans. Bank call loans are generally payable on demand and bear interest at various rates but not exceeding the broker call rate. These loans, collateralized by firm and customer securities (with market values of approximately \$17,201,000 and \$216,333,000, respectively), at September 30, 2006, are primarily with two U.S. money center banks.

*Margin lending*

The Company provides margin loans to its clients, which are collateralized by securities in their brokerage accounts. The Company monitors required margin levels and clients are required to deposit additional collateral, or reduce positions, when necessary.

At September 30, 2006, the Company had approximately \$1.5 billion of customer securities under customer margin loans that are available to be pledged of which the Company has repledged approximately \$489,001,000 under securities loan agreements.

Included in receivable from customers is a receivable from one customer in the amount of \$79,851,000 which is collateralized with fixed income securities in the amount of \$113,218,000, which mitigates the credit risk.

#### *Securities owned*

The Company pledges its securities owned to collateralize securities lending and bank call loan transactions. Pledged securities that can be sold or repledged by the secured party are identified as Securities owned including amounts pledged on the condensed consolidated balance sheets. The carrying value of securities owned by the Company that have been loaned or pledged to counterparties where those counterparties do not have the right to sell or repledge the collateral was \$17,201,000 as at September 30, 2006 (\$22,537,000 as at September 30, 2005).

### **10. Financial instruments with off-balance sheet risk and concentration of credit risk**

In the normal course of business, the Company's securities activities involve execution, settlement and financing of various securities transactions. These activities may expose the Company to risk in the event customers, other brokers and dealers, banks, depositories or clearing organizations are unable to fulfill their contractual obligations.

The Company is exposed to off-balance sheet risk of loss on unsettled transactions in the event customers and other counterparties are unable to fulfill their contractual obligations. It is the Company's policy to periodically review, as necessary, the credit standing of each counterparty with which it conducts business.

Securities sold, but not yet purchased represent obligations of the Company to deliver the specified security at the contracted price and thereby create a liability to purchase the security in the market at prevailing prices. Accordingly, these transactions result in off-balance sheet risk, as the Company's ultimate obligation to satisfy the sale of securities sold, but not yet purchased may exceed the amount recognized on the condensed consolidated balance sheet. Securities positions are monitored on a daily basis.

The Company's customer financing and securities lending activities require the Company to pledge customer securities as collateral for various financing sources such as bank loans and securities lending. See note 9 above.

#### *Interest rate swaps*

On September 29, 2006, the Company entered into interest rate swap transactions to hedge the interest payments associated with the floating rate senior secured credit note, which is subject to change due to changes in 3-Month LIBOR. These swaps have been designated as cash flow hedges under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities . Changes in the fair value of the swap hedges are expected to be highly effective in offsetting changes in the interest payments due to changes in 3-Month LIBOR. Information on these swaps is summarized in the following table:



|   | September 30, |      |
|---|---------------|------|
|   | 2006          | 2005 |
| Notional principal amount               | \$99,000,000  | -    |
| Weighted-average variable interest rate | -             | -    |
| Weighted-average fixed interest rate    | 5.45%         | -    |
| Weighted-average maturity               | 1.7 years     | -    |

#### *Mortgage-backed securities TBAs*

The Company has some limited trading activities in pass-through mortgage-backed securities eligible to be sold in the "to-be-announced" or TBA market. TBAs provide for the forward or delayed delivery of the underlying instrument with settlement up to 180 days. The contractual or notional amounts related to these financial instruments reflect the volume of activity and do not reflect the amounts at risk. Unrealized gains and losses on TBAs are recorded in the condensed consolidated balance sheets in receivable from brokers and clearing organizations and payable to brokers and clearing organizations, respectively, and in the condensed consolidated statement of operations as principal transactions revenue. The credit risk for TBAs is limited to the unrealized market valuation gains recorded in the condensed consolidated balance sheets. Market risk is substantially dependent upon the value of the underlying financial instruments and is affected by market forces such as volatility and changes in interest rates. The table below summarizes the notional amounts of TBAs and fair values (carrying amounts) of the related assets and liabilities.

#### *Futures contracts*

Futures contracts represent commitments to purchase or sell securities at a future date and at a specified price. Credit risk and market risk exist with respect to these instruments. Credit risk associated with the contracts is limited to amounts recorded in the condensed consolidated balance sheet and is mitigated by performance guarantees provided by the clearing organization of the futures exchange. Notional or contractual amounts are used to express the volume of these transactions, and do not represent the amounts potentially subject to market risk. At September 30, 2006, the Company had open contracts for Chicago Board of Trade U.S. Treasury Bonds and U.S. Treasury Notes, which are used to hedge interest rate risk associated with holding fixed-income securities.

Fair values of the Company's financial instruments with off-balance sheet risk which are included in receivables from brokers and clearing organizations and payables to brokers and clearing organizations are as follows:

| Expressed in thousands of dollars | September 30, 2006 |        |             | September 30, 2005 |        |             |
|-----------------------------------|--------------------|--------|-------------|--------------------|--------|-------------|
|                                   | Notional           | Assets | Liabilities | Notional           | Assets | Liabilities |

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|                       |           |       |       |           |       |   |
|-----------------------|-----------|-------|-------|-----------|-------|---|
| Interest rate swaps   | \$ 99,000 | \$ -  | \$ -  | \$ -      | \$ -  | - |
| U.S. Treasury futures | 46,800    | -     | 312   | 42,900    | 578   | - |
| Purchase of TBAs      | 19,098    | 208   | -     | 31,974    | 237   | - |
| Sale of TBAs          | 18,583    | 3     | -     | 32,047    | -     | - |
| Total                 | \$183,481 | \$211 | \$312 | \$106,921 | \$815 | - |

#### Clearing arrangements

The Company has a clearing arrangement with Pershing LLC to clear certain transactions in foreign securities. The clearing broker has the right to charge the Company for losses that result from a client's failure to fulfill its contractual obligations. The Company has a relationship with R.J. O'Brien & Associates, which maintains an omnibus account on behalf of Oppenheimer and executes commodities transactions on all exchanges. Accordingly, the Company has credit exposures with these clearing brokers. The clearing brokers can rehypothecate the securities held on behalf of the Company. As the right to charge the Company has no maximum amount and applies to all trades executed through the clearing brokers, the Company believes there is no maximum amount assignable to this right. At September 30, 2006, the Company had recorded no liabilities with regard to this right. The Company's policy is to monitor the credit standing of these clearing brokers, all counterparties and all clients with which it conducts business.

### **11. Related Party Transactions**

The Company does not make loans to its officers and directors except under normal commercial terms pursuant to client margin account agreements. These loans are fully collateralized by such employee-owned securities.

### **12. Segment Information**

The table below presents information about the reported revenue and pre-tax profit of the Company for the periods noted. The Company's segments are described in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. The Company's business is conducted primarily in the United States. Asset information by reportable segment is not reported, since the Company does not produce such information for internal use.

|                         | Three months ended |           | Nine months ended |           |
|-------------------------|--------------------|-----------|-------------------|-----------|
|                         | September 30,      |           | September 30,     |           |
| In thousands of dollars | 2006               | 2005      | 2006              | 2005      |
| Revenue:                |                    |           |                   |           |
| Private Client          | \$140,435          | \$129,850 | \$436,220         | \$375,663 |
| Capital Markets         | 32,130             | 24,490    | 87,102            | 71,309    |
| Asset Management **     | 11,253             | 15,928    | 39,199            | 44,617    |
| Other *                 | 4,645              | 994       | 20,016            | 2,848     |
| Total                   | \$188,463          | \$171,262 | \$582,537         | \$494,437 |
| Operating Income:       |                    |           |                   |           |
| Private Client          | \$7,871            | \$8,511   | \$36,047          | \$18,419  |
| Capital Markets         | 977                | 2,588     | 7,896             | 8,056     |
| Asset Management **     | 91                 | 1,221     | 1,947             | 3,033     |
| Other *                 | 4,335              | (880)     | 12,590            | (3,034)   |
| Total                   | \$13,274           | \$11,440  | \$58,480          | \$26,474  |

\* Other for the three and nine months ended September 30, 2006 includes the net gain of approximately \$0.8 million and \$12.4 million, respectively, on the NYSE Group shares, described in note 4. Other for the three and nine months ended September 30, 2006 includes a net gain on the extinguishment of the Debentures of approximately \$3.6 million, described in note 5.

\*\* Advisory fees earned in 2005 included fees for the India and Asia Tigers Funds, which ceased to be managed by the Company in December 2005.

### **13. Subsequent event**

On October 23, 2006, the Company bought back the remaining \$20,000,000 of its outstanding Debentures issued to CIBC at par plus accrued interest of \$258,000 and a fee of \$117,000. The Debentures that were redeemed were exchangeable for 862,069 Class A Shares at the rate of \$23.20 per Class A Share (approximately 6% of the Class A Shares on a fully diluted basis). The Company used internally available funds and existing bank call loan facilities to repurchase this debt. The gain on extinguishment on the outstanding Debentures is approximately \$470,000.



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

The Company's condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Reference is also made to the Company's consolidated financial statements and notes thereto found in its Annual Report on Form 10-K for the year ended December 31, 2005.

The Company engages in a broad range of activities in the securities industry, including retail securities brokerage, institutional sales and trading, investment banking (both corporate and public finance), research, market-making, and investment advisory and asset management services. The Company provides its services from 82 offices in 21 states located throughout the United States. The Company conducts business from 2 offices in Latin America through local broker-dealers. Client assets entrusted to the Company as at September 30, 2006 totaled approximately \$55.9 billion. The Company provides investment advisory services through Oppenheimer Asset Management Inc. and Fahnestock Asset Management, operating as a division of Oppenheimer. Assets under fee-based management increased by 17% to \$14.3 billion at September 30, 2006 compared to \$12.2 billion at September 30, 2005, reflecting organic growth and includes approximately \$1 billion, which relates to a transaction-based investment advisory program that was introduced in January 2006. The assets under fee-based management at September 30, 2005 included approximately \$1.2 billion related to the Asia Tigers and India Funds which ceased to be managed by the Company in December 2005. The Company provides trust services and products through Oppenheimer Trust Company. The Company provides discount brokerage services through Freedom Investments Inc. and through BUYandHOLD, a division of Freedom. At September 30, 2006, the Company employed approximately 2,901 people, of whom 1,697 were registered representatives.

### **Critical Accounting Policies**

The Company's accounting policies are essential to understanding and interpreting the financial results reported in the condensed consolidated financial statements. The significant accounting policies used in the preparation of the Company's condensed consolidated financial statements are summarized in note 1 to the Company's consolidated financial statements and notes thereto found in its Annual Report on Form 10-K for the year ended December 31, 2005. Certain of those policies are considered to be particularly important to the presentation of the Company's financial results because they require management to make difficult, complex or subjective judgments, often as a result of matters that are inherently uncertain.

As of January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) 123-R, Share-Based Payment (related to the Company's outstanding stock options) resulting in approximately \$733,000 and \$2,699,000, respectively, in additional compensation expense in the three and nine months ended September 30, 2006. In prior periods the cost of stock options was presented on a pro forma basis in the notes to the condensed consolidated financial statements. The Company has always recorded compensation expense with respect to its other

share-based plans, although the method of computation of the expense may have changed with the adoption of SFAS 123-R.



During the three months ended September 30, 2006, there were no other material changes to matters discussed under the heading "Critical Accounting Policies" in Part II, Item 7 of the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

## Business Environment

The securities industry is directly affected by general economic and market conditions, including fluctuations in volume and price levels of securities and changes in interest rates, inflation, political events, investor participation levels, legal and regulatory, accounting, tax and compliance requirements and competition, all of which have an impact on commissions, firm trading, fees from accounts under investment management, and investment income as well as on liquidity. Substantial fluctuations can occur in revenues and net income due to these and other factors.

The New York Stock Exchange ( NYSE )/Archipelago merger (collectively referred to as NYSE Group ), which took place in March 2006, had a significant impact on the Company's financial results for the nine months ended September 30, 2006. Oppenheimer had been a member of the NYSE since 1880 and was the beneficial owner of three memberships (seats) carried at a cost of \$2.2 million. Pursuant to the plan of merger between NYSE and Archipelago, Oppenheimer surrendered its memberships in exchange for approximately \$809,000 in cash and 241,901 NYSE Group common shares, par value \$0.01 per share, in the aggregate. In lieu of the rights conferred by membership, Oppenheimer purchased the rights to an annual renewable trading license. This license allows Oppenheimer continued physical and electronic access to the NYSE trading facilities. The NYSE Group common shares are subject to a three-year restriction on transfer, which were scheduled to expire in equal one-third installments in March 2007, 2008, and 2009.

On May 4, 2006, the Company sold 156,588 shares of NYSE Group (consisting of 80,635 and 75,953 NYSE Group shares that were originally restricted until March 2007 and March 2008, respectively) at a price of \$61.50 per share (before commission) as part of a secondary offering by NYSE Group shareholders. The Company's pre-tax profit for the three and nine months ended September 30, 2006 reflect a net gain of approximately \$800,000 and \$12.4 million, respectively, related to the exchange of seats for cash and NYSE Group common shares. The Company has estimated the fair value of its remaining NYSE Group restricted shares to be approximately \$4.7 million.

The Company's pre-tax profit for the three and nine months ended September 30, 2006 include a net gain of \$3.6 million on the extinguishment of \$140,822,400 of its variable rate exchangeable debentures on July 31, 2006. For the most part, this gain represents the difference between interest expensed by the Company since the issuance of the debentures on January 6, 2003 at a 4.5% interest rate (the annual effective interest rate over the life of the debentures) compared to the actual interest costs of 3% in 2003 and 4% thereafter until July 31, 2006.

Economic and market conditions continued strong in the third quarter of 2006. Defying most expectations for the period, oil prices declined significantly, driving down inflationary expectations and resulting in lower interest rates

and higher stock prices with the Dow Jones Industrial Average setting new records. As the quarter came to a close, the expectations for higher levels of economic activity were being driven by high employment levels, strong retail sales and stable prices despite the continued downturn in the housing market.

Without including the gains from either the NYSE Group common shares or the debt extinguishment, the Company's revenue for the nine months ended September 30, 2006 increased by 15% compared to revenue for the same period of 2005. The revenue increase in both the three and nine months ended September 30, 2006 compared to the same periods of 2005 came from higher transactional revenue from both private client and capital markets sources and increased interest income. Interest income was impacted by higher rates.

Interest rate changes also impact the Company's fixed income businesses as well as its cost of borrowed funds. Interest rates were higher in the three and nine months ended September 30, 2006 compared to the same periods in 2005. Investor interest in fixed income securities is driven by attractiveness of published rates, the direction of rates and economic expectations. Volatility in bond prices also impacts opportunities for profits in fixed income proprietary trading. Management constantly monitors its exposure to interest rate fluctuations to mitigate risk of loss in volatile environments.

The Company is focused on growing its private client and asset management businesses through strategic additions of experienced financial advisors in its existing branch system and employment of experienced money management personnel in its asset management business. In addition, the Company is committed to the improvement of its technology capability to support client service and the expansion of its capital markets capabilities.

### Regulatory Environment

The brokerage business is subject to regulation by the SEC, the NYSE, the NASD and various state securities regulators. Events in recent years surrounding corporate accounting and other activities leading to investor losses resulted in the enactment of the Sarbanes-Oxley Act and have caused increased regulation of public companies. New regulations and new interpretations and enforcement of existing regulations are creating increased costs of compliance and increased investment in systems and procedures to comply with these more complex and onerous requirements. Increasingly, the various states are imposing their own regulations that make the uniformity of regulation a thing of the past, and make compliance more difficult and more expensive to monitor. This regulatory environment has resulted in increased costs of compliance with rules and regulations, in particular, the impact of the rules and requirements that were created by the passage of the Patriot Act, and the anti-money laundering regulations (AML) that are related thereto. The expectation is that the increased costs of compliance in today's regulatory environment are not temporary.

The NASD (Rule 3013) and the NYSE (Rule 342) have instituted new rules relating to supervisory control processes. On March 31, 2006, the Chief Executive Officers (CEOs) of regulated broker-dealers (including the CEO of Oppenheimer) certified that their companies have processes to establish and test policies and procedures reasonably designed to achieve compliance with federal securities laws and regulations, including applicable regulations of self-regulatory organizations. The CEO of the Company will be required to make such certification on an annual basis.



*Mutual Fund Inquiry*

Since the third quarter of 2003, Oppenheimer has been responding to the SEC, the NY State Attorney General (the NYAG ), the NYSE, the NASD and other regulators as part of an industry-wide review of market timing, late trading and other activities involving mutual funds. The Company has answered several document requests and subpoenas and there have been on-the-record interviews of Company personnel. On June 5, 2006, Oppenheimer received an invitation from the NYSE to make a Wells Submission (a formal response to a request from a regulator that describes why an action should not be brought) with respect to its activities as a broker/dealer and as a clearing firm in connection with allegedly improper market timing (not late trading) of mutual funds by several former employees. Oppenheimer has filed a response with the NYSE.

The Company believes that a few of its former financial advisors, working from a single branch office, engaged in activities that are the subject of the SEC's inquiry largely during the period before the Company acquired the U.S. Private Client Division of CIBC World Markets on January 3, 2003.

The former employees and a current employee who had a supervisory role with respect to such financial advisors are being investigated by the SEC and the NYAG and have received "Wells Notices" from the SEC. There is no evidence that either the Company or its employees were engaged in "late trading". The Company has set aside reserves that it believes should address its financial exposure with respect to these matters. The Company continues to closely monitor its mutual fund activities and the activities of its employees.

#### *Other Regulatory Matters*

The Company has been the subject of various regulatory investigations with respect to its operations up to and including 2005. Most of these matters revolve around the period when the Company was transferring the business and client accounts of various acquisitions it has made to a common systems platform between September 2001 and June 2003. During that period of time, the Company absorbed approximately 35 branch offices and 1,000 financial advisors, and transitioned more than 250,000 client accounts from four separate and distinct companies, each of which utilized a different technology platform. The Company's business doubled during this period. As previously reported, certain of the Company's operations were impacted beginning in June 2003 and the Company experienced client service issues, which were subsequently corrected. The new businesses undertaken by the Company and the effect on the Company's operations for the period described above has resulted in investigations by the SEC, the NYSE, and the NASD. With the exception of the mutual funds timing matter described above, the Company has settled substantially all outstanding matters with the NYSE. With the exception of the matters described below, the Company has settled substantially all outstanding matters with the NASD.

On January 9, 2006, the NASD filed an action against Oppenheimer and its Chairman and CEO (the "2006 Complaint") for alleged violations with respect to the Company's filing of the NASD mutual fund breakpoint survey in 2003. This action could result in, among other things, monetary penalty, censure, suspension and/or other remedial sanctions. As previously disclosed, Oppenheimer had previously informed the NASD of certain limitations within its system relative to selecting out and generating data in the form requested by the NASD, and the NASD had stated that





no extensions to file would be granted to any firm. As a result, just prior to the deadline, Oppenheimer submitted the data it then had available. The NASD informed Oppenheimer within two days that its submission was deficient. The Company and Mr. Lowenthal, the Chairman and CEO, maintain that the assignment of overall responsibility for the response to the 2003 survey was properly delegated by the CEO to individuals who had the requisite experience and background to

complete and file the survey with the NASD. The Company and Mr. Lowenthal believe that they have strong defenses for the action brought against them because of these issues and intend to vigorously defend the action. As the NASD itself notes, the issuance of a disciplinary complaint represents the initiation of a formal proceeding by the NASD in which the allegations have not been heard or determined and does not represent a decision as to any of the allegations contained in the complaint.

Prior to the filing of the 2006 Complaint, the Company advised the NASD that it had reviewed the actual breakpoints applied for the period 2001 through 2005, a period longer than required by the NASD of similar member firms, and has returned to customers approximately \$600,000 in breakpoint credits and revised and enhanced its procedures for determining applicable breakpoints. All amounts due to customers have been refunded. The Company believes that it has taken all reasonable steps to resolve this industry-wide issue. The Company believes that the breakpoint survey matter was an industry-wide problem and that the Company has appropriately addressed in all respects the breakpoint issue with its clients.

The Company and Mr. Lowenthal are cooperating, have been cooperating and intend to continue to cooperate with all regulators and hope to reach a fair resolution of all outstanding regulatory issues. The Company has and continues to request an expedited adjudication of the matters in dispute.

On August 2, 2006, the Massachusetts Securities Division (the MSD ) filed an administrative complaint against the Company's main operating subsidiary, Oppenheimer & Co. Inc., as well as a financial advisor formerly employed by Oppenheimer alleging that Oppenheimer violated the Massachusetts Uniform Securities Act by failing to provide reasonable supervision of the former financial advisor thereby allowing the former financial advisor to engage in unlawful activity in the State of Massachusetts. The Company has filed an answer to the complaint and believes its supervision was reasonable and in accordance with industry standards.

In connection with the above matter, the MSD requested that Oppenheimer review and produce emails with respect to the former financial advisor and Oppenheimer's supervision thereof. As a result of this request, the MSD commenced an investigation into the responses made to it in connection with the retention and retrieval of emails which may result in further action being taken by the MSD.

Oppenheimer is cooperating and will continue to cooperate with the MSD's inquiry and hopes to reach a fair resolution of all outstanding regulatory issues.



On October 4, 2006, the Company reached settlement with the NASD over matters (initially alleged on May 3, 2005) relating to inaccuracies in its reporting to the Municipal Securities Rulemaking Board ( MSRB ) in May and June 2003, its failure to maintain electronic communications in a manner prescribed under SEC rules from July 2002 through the first quarter of 2004, as well as its policies and procedures related to these matters. The settlement required payment of a fine in the amount of \$800,000 (which had been fully reserved in prior periods) and the review, modification and enhancement of certain supervisory procedures.

As noted above, certain regulatory issues between the Company and the NYSE and NASD remain outstanding. As part of its ongoing business, the Company records reserves for legal expenses, judgments, fines and/or awards attributable to litigation and regulatory matters. In connection therewith, the Company has maintained its legal reserves at levels it believes will resolve outstanding matters, but may increase or decrease such reserves as matters warrant.

#### Business Continuity

The Company is committed to an on-going investment in its technology and communications infrastructure including extensive business continuity planning and investment. These costs are on-going and the Company believes that current and future costs will exceed historic levels due to business and regulatory requirements. The Company believes that internally-generated funds from operations are sufficient to finance its expenditure program.

#### Results of Operations

Net profit for the three months ended September 30, 2006 was \$7,673,000 or \$0.60 per share, an increase of 16% when compared to \$6,618,000 or \$0.51 per share in the same period of 2005. Revenue for the three months ended September 30, 2006 was \$188,463,000, an increase of 10% compared to revenue of \$171,262,000 in the same period of 2005. Expenses increased by 10% in the three months ended September 30, 2006 compared to the same period of 2005, primarily reflecting increased compensation and related costs and interest expense. The Company's pre-tax profit for the three months ended September 30, 2006 include a net gain of \$3.6 million on the extinguishment of \$140,822,400 of its variable rate exchangeable debentures on July 31, 2006. For the most part, this gain represents the difference between interest expensed by the Company since the issuance of the debentures on January 6, 2003 at a 4.5% interest rate (the annual effective interest rate over the life of the debentures) compared to the actual interest costs of 3% in 2003 and 4% thereafter until July 31, 2006.

Net profit for the nine months ended September 30, 2006 was \$34,027,000 or \$2.66 per share, an increase of 124% in net profit when compared to \$15,178,000 or \$1.16 per share in the same period of 2005. Revenue for the nine months

ended September 30, 2006 was \$582,537,000 compared to \$494,437,000 for the same period in 2005, an increase of 18%. Expenses increased by 12% in the nine months ended September 30, 2006 compared to the same period of 2005, with increases in compensation and related expenses and interest expense. The Company's pre-tax profit for the nine months ended September 30, 2006 include a gain (most of which was generated in the first quarter

of 2006) of approximately \$12.4 million related to the conversion of its three New York Stock Exchange memberships to NYSE Group common shares in March 2006 and the sale, in May 2006, of approximately two thirds of its investment in NYSE Group. The remaining investment in NYSE Group is marked to market each period. In addition, as described above, the pre-tax profit for nine months ended September 30, 2006 includes the net gain of \$3.6 million on extinguishment of the Debentures.

At September 30, 2006, shareholders' equity was approximately \$346 million and book value per share was \$27.00 compared to shareholders' equity of approximately \$304 million and book value of \$23.89 at September 30, 2005.

The Company's expenses increased by approximately 10% and 12%, respectively, for the three and nine months ended September 30, 2006 compared to the same periods in 2005 primarily due to increased compensation and related costs as well as higher interest expense. Compensation expense

tracks the trend in transactional revenue and includes the impact of the expensing of stock options since January 1, 2006. Interest expense tracks the increase in interest revenue and is the result of higher interest rates, increased stock loan activity in 2006 and the higher debt carrying costs compared to 2005. As previously reported, on July 31, 2006, the Company issued a senior secured credit note in the amount of \$125 million at a variable interest rate based on the London Interbank Offering Rate (LIBOR) with a seven-year term to a syndicate led by Morgan Stanley Senior Funding Inc, as agent. Minimum principal repayments equal 0.25% per quarter and there are required prepayments of principal based on a portion of the Company's excess cash flow, the net cash proceeds of asset sales, tax refunds over certain limits, awards over certain limits in connection with legal actions or takings, and debt issuances or other liability financings. For August and September of 2006, the interest rate on the senior secured credit note was 8.2%.

Effective January 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) 123-R, Share-Based Payment. The Company recorded additional compensation expense in the three and nine months ended September 30, 2006 of \$733,000 and \$2,699,000, respectively, with respect to its equity incentive plan. In prior years, the cost of stock options was presented on a pro forma basis in the notes to the condensed consolidated financial statements. The Company has always recorded compensation expense with respect to its other share-based plans, although the method of computation of the expense may have changed with the adoption of SFAS 123-R.





The following table and discussion summarizes the changes in the major revenue and expense categories for the periods presented (in thousands of dollars):

|                                | Three Months ended                |                      | Nine Months ended                 |                      |
|--------------------------------|-----------------------------------|----------------------|-----------------------------------|----------------------|
|                                | September 30,<br>2006 versus 2005 |                      | September 30,<br>2006 versus 2005 |                      |
|                                | Period to<br>Period Change        | Percentage<br>Change | Period to<br>Period Change        | Percentage<br>Change |
| Revenue -                      |                                   |                      |                                   |                      |
| Commissions                    | +3,453                            | +4%                  | +30,597                           | +13%                 |
| Principal transactions, net    | +2,844                            | +11%                 | +14,862                           | +21%                 |
| Interest                       | +6,423                            | +31%                 | +27,838                           | +52%                 |
| Investment banking             | -247                              | -2%                  | -2,429                            | -6%                  |
| Advisory fees                  | +599                              | +2%                  | -998                              | -1%                  |
| Other                          | +4,129                            | +88%                 | +18,230                           | +172%                |
| Total revenue                  | +17,201                           | +10%                 | +88,100                           | +18%                 |
| Expenses -                     |                                   |                      |                                   |                      |
| Compensation and related costs | +7,707                            | +7%                  | +31,150                           | +10%                 |
| Clearing and exchanges fees    | +34                               | +1%                  | -237                              | -2%                  |
| Communications and technology  | +981                              | +8%                  | +1,270                            | +3%                  |
| Occupancy and equipment costs  | +693                              | +6%                  | +2,210                            | +6%                  |
| Interest                       | +5,558                            | +48%                 | +20,565                           | +76%                 |
| Other                          | +394                              | +3%                  | +1,136                            | +3%                  |
| Total expenses                 | +15,367                           | +10%                 | +56,094                           | +12%                 |
| Profit before taxes            | +1,834                            | +16%                 | +32,006                           | +121%                |
| Income taxes                   | +779                              | +16%                 | +13,157                           | +116%                |
| Net profit                     | +1,055                            | +16%                 | +18,849                           | +124%                |

*Revenue, other than interest*

Commission income and, to a large extent, income from principal transactions depend on investor participation in the markets. In the three and nine months ended September 30, 2006, commission revenue increased by 4% and 13%, respectively, compared to the same periods of 2005 primarily as a result of increased investor activity in the equity markets. Net revenue from principal transactions increased by 11% and 21%, respectively, in the three and nine months ended September 30, 2006 compared to the comparable periods of 2005 due primarily to stronger market conditions. Investment banking revenues decreased 2% and 6%, respectively, in the three and nine months ended September 30, 2006 compared with the same periods of 2005 due to the drop in new and secondary issues as well as the drop in issuance of closed end investment funds in 2006 compared to 2005. The decrease in market activity levels for investment banking is related to the higher interest rate environment in 2006 compared to 2005. Advisory fees increased by 2% for the three months ended September 30, 2006 and decreased by 1% for the nine months ended September 30, 2006 compared to the same periods of 2005. The level of advisory fees earned in the nine months ended September 30, 2006 reflects the loss of the advisory contracts for the Asia Tigers and India Funds in December 2005. Assets under management by the asset management group were \$14.2 billion at September 30, 2006 (of which approximately \$1 billion applies to a new transaction-based investment advisory program effective January 2006) compared to \$12.2 billion at September 30, 2005, reflecting that clients are increasingly interested in fee-based services. Other revenue in the nine months ended September 30, 2006 includes a gain on the exchange of the Company's NYSE seats for cash and NYSE Group common shares of \$12.4 million and a net gain of \$3.6 million on extinguishment of the Debentures, as described above.

*Interest*

Net interest revenue (interest revenue less interest expense) increased by 9% and 28%, respectively, in the three and nine months ended September 30, 2006 compared to the same periods of 2005. Interest revenue, which primarily relates to revenue from customer margin balances and securities lending activities, increased by 31% and 52%, respectively, in the three and nine months ended September 30, 2006 compared to the same periods in 2005 primarily as a result of higher interest rates in 2006 and higher customer debit balances. Interest expense has increased due to higher interest rates and the increased interest cost of the refinanced debt.

*Expenses, other than interest*

Compensation and related costs increased by 7% and 10%, respectively, in the three and nine months ended September 30, 2006 compared to the comparable periods of 2005. Compensation expense, including the Company's accrual for year-end bonuses, has volume-related components and, therefore, increased with the increased levels of commission and principal transactions business conducted in the three and nine months ended September 30, 2006 compared to the comparable periods of 2005. The amortization of forgivable loans to brokers is included in compensation expense. This expense is relatively fixed and is not influenced by increases or decreases in revenue levels, but rather by the net number of financial advisors hired in one period compared to another. As of January 1, 2006, the Company adopted SFAS 123-R, *Shares-Based Payment*, resulting in approximately \$733,000 and \$2,699,000, respectively, in compensation

expense in the three and nine months ended September 30, 2006 relating to the expensing of stock options. In prior periods, the Company provided pro forma disclosure of the impact of employee stock options in the notes to its condensed consolidated financial statements. The cost of clearing and exchange fees increased by 1%, in the three months ended September 30, 2006 and decreased by 2% in the nine months ended September 30, 2006 compared to the comparable periods of 2005. The cost of communications and technology increased by 8% and 3%, respectively, in the three and nine months ended September 30, 2006 compared to the comparable periods of 2005, driven primarily by the increased costs of external data services to support the increased level of business in 2006 compared to 2005. Occupancy and equipment costs increased by 6% in the both the three and nine months ended September 30, 2006 compared to the same periods of 2005. The increase in 2006 is primarily due to escalating costs of premises-related operating expenses. In addition, the Company has expanded and relocated several branch offices, incurring higher rental costs in 2006 compared to 2005. Other expenses increased by 3% in both the three and nine months ended September 30, 2006. Included in other expenses, bad debt expense decreased by approximately \$300,000 and was flat, respectively, in the three and nine months ended September 30, 2006 compared to the same periods in 2005. Legal and regulatory expenses, also included in other expenses, increased by approximately \$521,000 and decreased by approximately \$1,134,000 in the three and nine months ended September 30, 2006 compared to the same periods in 2005. See Regulatory Environment, above.

Other expenses will continue to be impacted by litigation and regulatory settlement costs. The Company may face additional legal costs and settlement expenses in future quarters. The Company has used its best estimate to provide adequate reserves to cover potential litigation and regulatory expenses. It is anticipated that the costs of compliance with regulatory authorities, as well as Sarbanes-Oxley Act compliance, will continue to be expensive.

#### Liquidity and Capital Resources

Total assets at September 30, 2006 decreased by less than 1% from December 31, 2005 levels. The Company satisfies its need for funds from its own cash resources, internally generated funds, collateralized and uncollateralized borrowings, consisting primarily of bank loans, and uncommitted lines of credit. The amount of Oppenheimer's bank borrowings fluctuates in response to changes in the level of the Company's securities inventories and customer margin debt, changes in stock loan balances and changes in notes receivable from employees. Oppenheimer has arrangements with banks for borrowings on an unsecured and on a fully collateralized basis. At September 30, 2006, \$70,377,000 of such borrowings were outstanding compared to outstanding borrowings of \$139,700,000 at



December 31, 2005. At September 30, 2006, the Company had available collateralized and uncollateralized letters of credit of \$145,200,000.

In connection with the acquisition of the Oppenheimer divisions from CIBC World Markets in January 2003, the Company issued debentures in the amount of approximately \$161,822,400 and a zero coupon promissory note in the amount of approximately \$65,513,000. The notes to the condensed consolidated financial statements contain a description of these instruments. As disclosed in note 5, \$140,822,400 of the debentures were redeemed on July 31, 2006 through the

issue of a senior secured credit note to a syndicate led by Morgan Stanley Senior Funding Inc., as agent, in the amount of \$125,000,000 plus internally available funds and an increase in bank call loans. The senior secured credit note has a term of seven years with minimum principal repayments of 0.25% per quarter and required prepayments based on a portion of the Company's excess cash flow, the net cash proceeds of asset sales, tax refunds over certain limits, awards over certain limits in connection with legal actions or takings, and debt issuances or other liability financings, and pays interest at a variable rate based on LIBOR (London Interbank Offering Rate). In accordance with the senior secured credit note, the Company has provided certain covenants to the lenders with respect to the maintenance of a minimum fixed charge ratio and maximum leverage ratio driven from EBITDA and minimum net capital requirements with respect to Oppenheimer. In the Company's view, the most restrictive of the covenants requires that the Company maintain a maximum leverage ratio of 2.30 (total long-term debt divided by EBITDA). At September 30, 2006, the Company was in compliance with the covenants. The interest rate on the senior secured credit note for the two months ended September 30, 2006 was 8.2%. Interest expense for the two months ended September 30, 2006 was \$1,708,000.

The obligations under the Credit Agreements are guaranteed by certain of the Company's subsidiaries, other than broker-dealer subsidiaries, with certain exceptions, and are secured by a lien on substantially all of the assets of each guarantor, including a pledge of the ownership interests in each first-tier broker-dealer subsidiary held by a guarantor, with certain exceptions.

On September 29, 2006, the Company entered into interest rate swap transactions to hedge the interest payments associated with the floating rate senior secured credit note, which is subject to change due to changes in 3-Month LIBOR. These swaps have been designated as cash flow hedges under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Changes in the fair value of the swap hedges are expected to be highly effective in offsetting changes in the interest payments due to changes in 3-Month LIBOR.

As disclosed in Note 13, on October 23, 2006, the Company redeemed the remaining \$20 million of the debentures out of internally available cash and an increase in bank call loans. The principal payments on the zero coupon promissory note are also being financed from internally generated funds. The Company believes that the necessary internally generated funds will be available to service these obligations from funds generated by normal operations, including funds generated by the acquired businesses.

In connection with the acquisition of the Oppenheimer divisions from CIBC World Markets in January 2003, the Company arranged a credit facility in the amount of \$50 million with CIBC. In January 2003, the Company borrowed \$25 million under this facility and borrowed the balance in July 2003. The borrowings were used to finance broker retention notes and were repayable, together with interest, at the CIBC U.S. base rate plus 2% over five years or earlier if any broker notes become due earlier. The Company fully retired this credit facility in January 2006 out of internally generated funds and an increase in bank call loans.





## Funding Risk

|  | Three months ended September<br>30, |           | Nine months ended September<br>30, |             |
|--|-------------------------------------|-----------|------------------------------------|-------------|
|  | 2006                                | 2005      | 2006                               | 2005        |
| Cash provided by (used in) operations                |                                     |           |                                    |             |
|  | \$59,929                            | \$115,210 | \$99,593                           | \$(114,110) |
| Cash used in investing activities                    | (2,440)                             | (1,341)   | (4,547)                            | (3,080)     |
| Cash (used in) provided by financing activities      |                                     |           |                                    |             |
|  | (66,890)                            | (103,738) | (108,860)                          | 134,582     |
| Net increase (decrease) in cash and cash equivalents |                                     |           |                                    |             |
|  | \$(9,401)                           | \$10,131  | \$(13,814)                         | \$17,392    |

During 2006, the Company made significant reductions in its long-term debt load. The refinancing of its exchangeable debentures has resulted in higher interest costs.

Management believes that funds from operations, combined with the Company's capital base and available credit facilities, are sufficient for the Company's liquidity needs in the foreseeable future. (See Factors Affecting Forward-Looking Statements ).

## Other Matters

During the third quarter of 2006, the Company did not purchase any Class A Shares pursuant to a Normal Course Issuer Bid.



During the third quarter of 2006, the Company issued 79,130 Class A Shares for a total consideration of \$1,965,000 related to employee exercises of options under the Company's equity incentive plan.

On August 18, 2006, the Company paid cash dividends of U.S. \$0.10 per Class A and Class B Share totaling \$1,277,000 from available cash on hand.

On October 30, 2006, the Board of Directors declared a regular quarterly cash dividend of U.S. \$0.10 per Class A and Class B Share payable on November 24, 2006 to shareholders of record on November 10, 2006.

The book value of the Company's Class A and Class B Shares was \$27.00 at September 30, 2006 compared to \$23.89 at September 30, 2005, an increase of approximately 13%, based on total outstanding shares of 12,812,202 and 12,733,521, respectively.

The diluted weighted average number of Class A non-voting and Class B shares outstanding for the three months ended September 30, 2006 was 15,773,199 compared to 20,032,893 outstanding for the three months ended September 30, 2005, a net decrease of 21% due to the redemption, on July 31, 2006, of \$140,822,400 of the Company's exchangeable debentures. The three months ended

September 30, 2006 represents the last quarterly period impacted by the dilution related to the shares exchangeable under the \$140,822,400 exchangeable debentures (exchangeable into 6,069,931 Class A Shares). The three months ending December 31, 2006 will represent the last quarterly period in which the remaining \$20,000,000 in exchangeable debentures (exchangeable into 862,069 Class A Shares) will have a dilutive impact on earnings per share.

#### Off-Balance Sheet Arrangements

Information concerning the Company's off-balance sheet arrangements is included in note 10 of the notes to the condensed consolidated financial statements. Such information is hereby incorporated by reference.

#### Contractual and Contingent Obligations

The Company has contractual obligations to make future payments in connection with non-cancelable lease obligations and debt assumed upon the 2003 acquisition of the Oppenheimer divisions from CIBC World Markets, as well as debt assumed upon the refinancing of the Debentures issued in 2003.

The following table sets forth these contractual and contingent commitments as at September 30, 2006:

Contractual Obligations (In millions of dollars)

|                              | Total | Less than 1<br>Year | 1-3 Years | 3-5 Years | More than 5<br>Years |
|------------------------------|-------|---------------------|-----------|-----------|----------------------|
| Minimum rentals              | \$148 | \$7                 | \$52      | \$41      | \$48                 |
| Debentures (1)               | 20    | -                   | -         | -         | 20                   |
| Senior Secured Credit Note   | 125   | -                   | 2         | 2         | 121                  |
| Zero coupon promissory notes |       |                     |           |           |                      |
|                              | 16    | 2                   | 5         | 3         | 6                    |
| Total                        | \$309 | \$9                 | \$59      | \$46      | \$195                |

(1)

See Note 13 to the condensed consolidated financial statements.

## Newly Issued Accounting Standards

### *Recently adopted*

In June 2005, the FASB ratified the consensus reached in Emerging Issues Task Force ( EITF ) Issue No. 04-5, *Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights* which requires a general partner(s) (or managing member(s) in the case of limited liability companies) to consolidate its partnerships or to provide limited partners with rights to remove the general partner(s) or to terminate the partnership. The Company serves as a general partner for a number of asset management limited partnerships through OAM and, therefore, was required to adopt the provisions of EITF Issue No. 04-5 immediately for partnerships formed or modified after June 29, 2005. For partnerships formed on or before June 29, 2005 that were not modified, the Company was required to adopt EITF 04-5 on January 1, 2006. The adoption of EITF Issue No. 04-5 did not have a material impact on the Company's condensed consolidated financial statements.

### *Recently issued*

In June 2006, the FASB issued Interpretation 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*, an interpretation of FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation requires that a tax position be recognized only if it is more likely than not to be sustained upon examination, including resolution of related appeals or litigation processes, based solely on its technical merits, as of the reporting date. A tax position that meets the more-likely-than-not criterion shall be measured at the largest amount of benefit that is more than 50 percent likely of being realized upon ultimate settlement. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company is currently evaluating the impact this guidance will have on the condensed consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 ( SFAS 157 ), *Fair Value Measurements*, which provides expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. SFAS 157 applies whenever other standards require (or permit) assets or liabilities to be measured at fair value and does not expand the use of fair value in any new circumstances. In addition, SFAS No. 157 prohibits recognition of block discounts for large holdings of unrestricted financial instruments where quoted prices are readily and regularly available in an active market. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years with early adoption permitted. The Company is currently evaluating the impact this guidance will have on the condensed consolidated financial statements.





## Factors Affecting Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). These forward-looking statements relate to anticipated financial performance, future revenues or earnings, the results of litigation, business prospects and anticipated market performance of the Company. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company cautions readers that a variety of factors could cause the Company's actual results to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements. These risks and uncertainties, many of which are beyond the Company's control, include, but are not limited to: (i) transaction volume in the securities markets, (ii) the volatility of the securities markets, (iii) fluctuations in interest rates, (iv) changes in regulatory requirements which could affect the cost and manner of doing business, (v) fluctuations in currency rates, (vi) general economic conditions, both domestic and international, (vii) changes in the rate of inflation and the related impact on the securities markets, (viii) competition from existing financial institutions and other new participants in the securities markets, (ix) legal or

economic developments affecting the litigation experience of the securities industry or the Company, (x) changes in federal and state tax laws which could affect the popularity of products and services sold by the Company, (xi) the effectiveness of efforts to reduce costs and eliminate overlap, (xii) war and nuclear confrontation, (xiii) the Company's ability to achieve its business plan and (xiv) corporate governance issues. See Risk Factors in the Company's Annual Report on Form 10-K for the year ended December 31, 2005. There can be no assurance that the Company has correctly or completely identified and assessed all of the factors affecting the Company's business. The Company does not undertake any obligation to publicly update or revise any forward-looking statements.

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

During the three months ended September 30, 2006, there were no material changes to the information contained in Part II, Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

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

The Company carried out an evaluation, under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of its disclosure controls and procedures pursuant to Rule 13a-15(e) of the Exchange Act. Based on this evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

Management, including the Chief Executive Officer and Chief Financial Officer, does not expect that the Company's disclosure controls and procedures or its internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include, but are not limited to, the realities that judgments in decision making can be faulty and that break-downs can occur because of a simple error or omission. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. The design of any system of controls also is based, in part, upon certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions; over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost effective control system, misstatements due to error or fraud may occur and not be detected.

#### Changes in Internal Control over Financial Reporting

No changes in the Company's internal controls over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting, occurred during the quarter ended September 30, 2006.

## **PART II**

### **OTHER INFORMATION**

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

Many aspects of the Company's business involve substantial risks of liability. In the normal course of business, the Company has been named as defendant or co-defendant in lawsuits creating substantial exposure. The Company is also involved in governmental and self-regulatory agency investigations and proceedings. See Regulatory Environment under Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations. The Company and others in the financial services industry have been involved in increased incidences of litigation and regulatory investigations in recent years, including customer claims seeking, in total, substantial damages.

The Company is the subject of customer complaints, has been named as defendant or codefendant in various lawsuits seeking, in total, substantial damages and is involved in certain governmental and self-regulatory agency investigations and proceedings. These proceedings arise primarily from securities brokerage, asset management and investment banking activities. While the ultimate resolution of pending litigation and other matters cannot be currently determined, in the opinion of management, after consultation with legal counsel, the Company has no reason to believe that the resolution of these matters will have a material adverse effect on its financial condition. However, the Company's results of operations could be materially affected during any period if liabilities in that period differ from prior estimates. The materiality of legal matters to the Company's future operating results depends on the level of future results of operations as well as the timing and ultimate outcome of such legal matters.

#### **ITEM 1A. Risk Factors**

During the three months and nine months ended September 30, 2006, there were no material changes to the information contained in Part I, Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2005.

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

Not applicable

**ITEM 3. Defaults Upon Senior Securities**

Not applicable

**ITEM 4. Submission of Matters to a Vote of Security Holders**

None

**ITEM 5. Other Information**

Not applicable

**ITEM 6. Exhibits**

Exhibits

- 31.1 Certification of Albert G. Lowenthal
- 31.2 Certification of Elaine K. Roberts
- 32.1 Certification of Albert G. Lowenthal and Elaine K. Roberts

## 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 hereunto duly authorized, in the City of Toronto, Ontario, Canada on this 8th day of November, 2006.

OPPENHEIMER HOLDINGS INC.

By: A.G. Lowenthal

A.G. Lowenthal, Chairman and Chief Executive Officer

(Principal Executive Officer)

By: E.K. Roberts

E.K. Roberts, President, Treasurer and Chief Financial Officer

(Principal Financial and Accounting Officer)