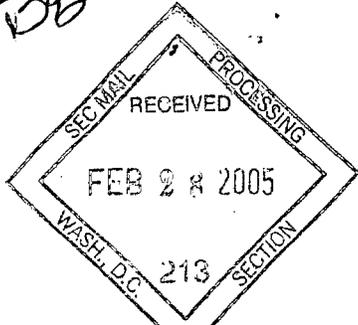


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# ANNUAL AUDITED REPORT FORM X-17A-5 PART III

SEC FILE NUMBER  
8- ~~38599~~ 48311

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## Information Required of Brokers and Dealers Pursuant to Section 17 of the Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

REPORT FOR THE PERIOD BEGINNING 01/01/04 AND ENDING 12/31/04  
MM/DD/YY MM/DD/YY

### A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER: Knight Equity Markets, L.P.

OFFICIAL USE ONLY  
FIRM I.D. NO.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

525 Washington Boulevard

(No. and Street)

Jersey City

NJ

07310

(City)

(State)

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Tim Dunham

(201) 557-6886

(Area Code - Telephone Number)

### B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report\*

PricewaterhouseCoopers LLP

(Name - if individual, state last, first, middle name)

300 Madison Avenue

New York

NY

10017

(Address)

(City)

(State)

(Zip Code)

CHECK ONE:

- Certified Public Accountant
- Public Accountant
- Accountant not resident in United States or any of its possessions.

PROCESSED

MAR 17 2005

THOMSON  
FINANCIAL

FOR OFFICIAL USE ONLY

\*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

SEC 1410 (06-02)

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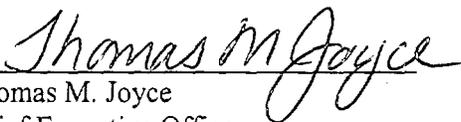
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OATH OR AFFIRMATION

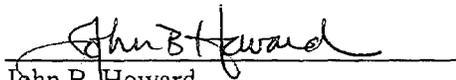
STATE OF NEW JERSEY

COUNTY OF HUDSON

We, the undersigned officers of the firm of Knight Equity Markets, L.P., affirm that, to the best of our knowledge and belief, the accompanying financial statements and supplementary schedules pertaining to Knight Equity Markets, L.P. for the year ended December 31, 2004 are true and correct. We further affirm that neither the Company nor any principal officer or director has any proprietary interest in any account classified solely as that of a customer.



Thomas M. Joyce  
Chief Executive Officer



John B. Howard  
Senior Managing Director and  
Chief Financial Officer



Notary Public

**SHARON GAUTIER LOPEZ**  
Notary Public, State of New Jersey  
No. 2271908  
Qualified in Hudson County  
Commission Expires February 7, 2006



# **Knight Equity Markets, L.P.**

Statement of Financial Condition

December 31, 2004

**Knight Equity Markets, L.P.**

**Index**

**December 31, 2004**

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**Page(s)**

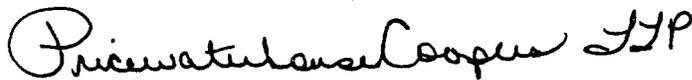
This report contains the following:

Report of Independent Auditors.....	2
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**Report of Independent Auditors**

To the Partners of  
Knight Equity Markets, L.P.:

In our opinion, the accompanying statement of financial condition presents fairly, in all material respects, the financial position of Knight Equity Markets, L.P. at December 31, 2004, in conformity with accounting principles generally accepted in the United States of America. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit of this statement in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statement, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.



January 18, 2005

**Knight Equity Markets, L.P.**  
**Statement of Financial Condition**  
**December 31, 2004**

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<b>Assets</b>	
Cash and cash equivalents	\$ 148,896,398
Cash segregated under federal and other regulations	5,946,791
Securities owned, held at clearing broker, at market value	135,933,168
Receivable from brokers, dealers and clearing organizations	81,109,749
Fixed assets and leasehold improvements, at cost, less accumulated depreciation and amortization of \$80,946,737	48,449,038
Strategic investment	9,550,233
Intangible assets, less accumulated amortization of \$630,139	11,369,861
Goodwill	3,589,747
Other assets	13,434,832
<b>Total assets</b>	<b>\$ 458,279,817</b>
<b>Liabilities and Partners' Capital</b>	
<b>Liabilities</b>	
Securities sold, not yet purchased, at market value	\$ 97,805,786
Accrued compensation expense	49,257,628
Payable to brokers, dealers and clearing organizations	15,572,821
Accrued soft dollar and commission recapture expense	9,950,322
Lease loss accrual	15,564,984
Accrued expenses and other liabilities	17,791,692
<b>Total liabilities</b>	<b>205,943,233</b>
Commitments and contingent liabilities (Notes 6 and 10)	
Partners' capital	252,336,584
<b>Total liabilities and partners' capital</b>	<b>\$ 458,279,817</b>

The accompanying notes are an integral part of this statement of financial condition.

**1. Organization and Description of the Business**

Knight Equity Markets, L.P. (the "Company"), a limited partnership organized in the state of Delaware, operates as a market maker in over-the-counter equity securities ("OTC securities"), primarily those traded on the Nasdaq Stock Market and on the OTC Bulletin Board. The Company is registered as a broker-dealer with the Securities and Exchange Commission ("SEC") and is a member of the National Association of Securities Dealers, Inc. ("NASD"), the National Stock Exchange, and the Pacific Stock Exchange. The Company's general partner is Knight Securities General, Inc. and its limited partner is Knight Securities Operations, Inc. The Company's ultimate parent is Knight Trading Group, Inc. ("KTG").

**2. Significant Accounting Policies**

**Cash Equivalents**

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

**Market Making Activities**

Securities owned and securities sold, not yet purchased, which consist of OTC and listed equity securities, are carried at market value and are recorded on a trade date basis.

**Estimated Fair Value of Financial Instruments**

Management estimates that the fair value of financial instruments recognized on the Statement of Financial Condition (including receivables, payables and accrued expenses) approximates their carrying value, as such financial instruments are short-term in nature, bear interest at current market rates or are subject to frequent repricing.

**Goodwill and Intangible Assets**

The Company applies the provisions of Statement of Financial Accounting Standards ("SFAS") No. 142 *Goodwill and Other Intangible Assets*. Under this standard, goodwill and intangible assets with an indefinite useful life are not amortized but are tested for impairment annually or when an event occurs or circumstances change that signify the existence of impairment. The Company has no indefinite-lived intangible assets. Other intangible assets are amortized over their useful lives, which have been determined to range from five to thirty years.

**Strategic Investment**

Strategic investment, which represents an investment in NASDAQ, is accounted for at fair value. The fair value of the investment, for which a quoted market or dealer price is not available for the size of the Company's investment, is based on management's estimate. Among the factors considered by management in determining the fair value of investments are the cost of the investment, terms and liquidity, developments since the acquisition of the investment, the sales price of recently issued securities, the financial condition and operating results of the issuer, earnings trends and consistency of operating cash flows, the long-term business potential of the issuer, the quoted market price of securities with similar quality and yield that are publicly traded, and other factors generally pertinent to the valuation of investments. The fair value of this investment is subject to a high degree of volatility and may be susceptible to significant

fluctuations in the near term. The valuation of the investment is reviewed by management on an ongoing basis.

**Depreciation and Amortization**

Fixed assets are being depreciated on a straight-line basis over their estimated useful lives of three to seven years. Leasehold improvements are being amortized on a straight-line basis over the shorter of the life of the applicable office lease or the expected useful life of the assets. The Company capitalizes certain costs associated with the acquisition or development of internal-use software and amortizes the software over its estimated useful life of three years.

**Lease Loss Accruals**

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

**Other**

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

**3. Receivable From and Payable to Brokers, Dealers and Clearing Organizations**

Receivable from and Payable to brokers, dealers and clearing organizations at December 31, 2004 consist of the following:

	Receivable	Payable
Receivable from clearing brokers	\$ 65,249,993	-
Securities failed-to-deliver/receive	10,996,736	\$ 8,872,154
Deposits for securities borrowed	4,529,606	-
Payments for order flow	-	1,765,453
Clearance, execution and other fees	333,414	4,935,214
	<u>\$ 81,109,749</u>	<u>\$ 15,572,821</u>

Included in securities failed to deliver and securities failed to receive are \$4.4 million and \$4.8 million receivable from and payable to an affiliate, respectively.

**4. Goodwill and Intangible Assets**

At December 31, 2004, the Company had goodwill and intangible assets of \$3,589,747 and \$11,369,861, respectively, which resulted from the purchase of the business of Donaldson & Co., Incorporated, on December 1, 2003.

The intangible assets, which are primarily customer relationships, are all deemed to have definite lives and are being amortized over their useful lives, which have been determined to range from five to thirty years.

Under SFAS 142, goodwill and the useful lives of intangible assets are tested for impairment, at a minimum, on an annual basis, or when an event occurs or circumstances change that signify the existence of impairment. In June 2004, the Company tested for the impairment of goodwill and intangible assets and concluded that there was no impairment.

**5. Fixed Assets and Leasehold Improvements**

Fixed assets and leasehold improvements are composed of the following:

Computer hardware and software	\$ 75,719,872
Leasehold improvements	40,459,438
Equipment	1,751,694
Telephone system	6,425,318
Furniture and fixtures	5,039,453
	<u>129,395,775</u>
Less: Accumulated depreciation and amortization	<u>(80,946,737)</u>
	<u>\$ 48,449,038</u>

**6. Commitments and Contingent Liabilities**

The Company leases office space under noncancelable operating leases, which contain certain escalation clauses whereby the rental commitments may be increased if certain conditions are satisfied and specify yearly adjustments to the lease amounts based on annual adjustments according to the Consumer Price Index.

The Company leases certain computer and office equipment under noncancelable operating leases. In addition, the Company has entered into guaranteed employment contracts with certain of its employees. As of December 31, 2004, future minimum rental commitments under all noncancelable office leases, and computer and equipment leases, guaranteed employment contracts longer than one year and other commitments ("Other Obligations") were as follows:

	Office Leases	Other Obligations	Total
<b>Year ending December 31,</b>			
2005	\$ 12,057,722	\$ 3,857,650	\$ 15,915,372
2006	8,483,272	3,726,276	12,209,548
2007	7,908,522	4,314	7,912,836
2008	7,819,718	330	7,820,048
2009	7,733,838	-	7,733,838
Thereafter through September 30, 2021	105,177,060	-	105,177,060
	<u>\$ 149,180,132</u>	<u>\$ 7,588,570</u>	<u>\$ 156,768,702</u>

During the normal course of business, the Company collateralizes certain leases through letters of credit. As of December 31, 2004, KTG has provided a \$9.0 million letter of credit as a guarantee for one of the Company's lease obligations.

The Company has been named as a defendant in legal actions. In addition, from time to time, the Company is a party to examinations and inquiries by various regulatory and self-regulatory bodies. In the opinion of management, based on consultation with legal counsel, any adverse outcome with regard to these matters would not likely have a material adverse effect on the results of operations or the financial position of the Company.

**7. Significant Clients**

The Company considers significant clients to be clients who account for 10% or more of the total U.S. equity dollar value traded by the Company during the period. One customer accounted for approximately 11.6% of the Company's U.S. equity dollar value traded.

**8. Employee Benefit Plans**

KTG sponsors a 401(k) profit sharing plan (the "Plan") in which substantially all employees are eligible to participate. Under the terms of the Plan, the Company is required to make contributions to the Plan equal to 100% of the contributions made by each Company participant, up to certain limitations.

Certain employees of the Company participate in KTG's stock option and award plan (the "Stock Plan"), which provides for the issuance of KTG stock-related awards. It is KTG's policy to grant options for the purchase of shares of KTG's Class A Common Stock at not less than market value, which the Stock Plan defines as the average of the high and low sales prices on the date prior to the grant date. Options generally vest over a three or four-year period and expire on the fifth or tenth anniversary of the grant date, pursuant to the terms of the agreements. Restricted stock awards generally vest over three years. KTG has the right to fully vest employees in their option grants and restricted stock awards upon retirement and in certain other circumstances.

**9. Related Party Transactions**

Corporate overhead expenses are allocated to the Company by KTG based on direct usage, headcount, or a percentage of net capital depending on the source of the expense.

The Company pays an affiliate a fee for arranging transactions with European customers. The Company paid another affiliate a fee for arranging certain transactions.

The Company pays an affiliate a fee for certain costs associated with the operation of a disaster recovery site.

The Company pays affiliates a fee for certain execution costs.

At December 31, 2004, Other assets and Accrued expenses and Other liabilities on the Statement of Operations include \$4.4 million and \$1.6 million receivable from and payable to affiliates, respectively.

The Company receives a fee from an affiliate to manage an investment portfolio.

In the normal course of business, the Company makes short-term loans, payable on demand, to affiliated companies for which the Company charges an amount approximating its borrowing rate. At December 31, 2004 there were no loans receivable.

In addition, the Company borrowed funds from an affiliate during 2004 at a rate approximating its borrowing rate. At December 31, 2004 there were no loans payable.

**10. Financial Instruments with Off-Balance Sheet Risk and Concentrations of Credit Risk**

As a market maker of OTC securities, substantially all of the Company's OTC securities transactions are conducted as principal with broker-dealer and institutional counterparties located in the United States. The Company clears the majority of its domestic securities transactions through a clearing broker on a fully disclosed basis. Foreign transactions are settled pursuant to a global custody and clearing agreement with a major US commercial bank. Substantially all of the Company's credit exposures are concentrated with the bank and the clearing broker (the "clearing agents"). These clearing agents may re-hypothecate certain securities held on behalf of the Company. Additionally, pursuant to the terms of the agreements between the Company and the clearing agents, the clearing agents have the right to charge the Company for all losses that result from a counterparty's failure to fulfill its obligations. The Company has the ability to pursue collection from or performance of the counterparty. The Company's policy is to monitor the credit standing of the clearing agents and all counterparties with which it conducts business.

Securities sold, not yet purchased, which are valued at market, represent obligations of the Company to purchase such securities at a future date. The Company may incur a loss if the market value of the securities subsequently increases.

**11. Regulatory Charges and Related Matters**

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

The Settlement related to certain institutional trade activity, conduct and supervision that occurred in 1999 through 2001. The Settlement took the form of an administrative order, in which KSLP neither admitted nor denied the findings. The Settlement resolves the matters for which KSLP received Wells Notices from the staffs of the SEC and the NASD but does not address the Wells Notices received by four former employees of KSLP.

The terms of the Settlement provided that KSLP disgorge \$41.1 million in institutional trading profits, and pay approximately \$13.2 million in interest and \$25 million in penalties for a total of \$79.3 million. The Company did not record a tax benefit for the \$25.0 million penalty. The amount was paid in full in 2004.

**12. Net Capital Requirement**

As a registered broker-dealer and a NASD member firm, the Company is subject to the SEC's Uniform Net Capital Rule (the "Rule") which requires the maintenance of minimum net capital. The Company has elected to use the basic method, permitted by the Rule, which requires that the Company maintain net capital equal to the greater of \$1.0 million or 6 2/3% of aggregate indebtedness, as defined.

At December 31, 2004, the Company had net capital of \$129.2 million, which was \$122.3 million in excess of its required net capital of \$6.9 million.