

JMP Group Inc.
Form 10-Q
November 04, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from _____ to _____

Commission File Number: 001-33448

JMP Group Inc.

(Exact name of registrant as specified in its charter)

Edgar Filing: JMP Group Inc. - Form 10-Q

Delaware
(State or Other Jurisdiction of

20-1450327
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

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

(Address of principal executive offices)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

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

The number of shares of the Registrant's common stock, par value \$0.001 per share, outstanding as of November 2, 2009 was 21,533,583.

Table of Contents

TABLE OF CONTENTS

| | Page Number |
|--|------------------------|
| PART I. <u>FINANCIAL INFORMATION</u> | 4 |
| Item 1. <u>Financial Statements - JMP Group Inc.</u> | 4 |
| <u>Consolidated Statements of Financial Condition - September 30, 2009 and December 31, 2008 (Unaudited)</u> | 4 |
| <u>Consolidated Statements of Operations - For the Three and Nine Months Ended September 30, 2009 and 2008 (Unaudited)</u> | 5 |
| <u>Consolidated Statement of Changes in Equity - For the Nine Months Ended September 30, 2009 (Unaudited)</u> | 6 |
| <u>Consolidated Statements of Cash Flows - For the Nine Months Ended September 30, 2009 and 2008 (Unaudited)</u> | 7 |
| <u>Notes to Consolidated Financial Statements (Unaudited)</u> | 8 |
| Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 33 |
| Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u> | 53 |
| Item 4. <u>Controls and Procedures</u> | 53 |
| PART II. <u>OTHER INFORMATION</u> | 54 |
| Item 1. <u>Legal Proceedings</u> | 54 |
| Item 1A. <u>Risk Factors</u> | 54 |
| Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 55 |
| Item 3. <u>Defaults Upon Senior Securities</u> | 55 |
| Item 4. <u>Submission of Matters to a Vote of Security Holders</u> | 55 |
| Item 5. <u>Other Information</u> | 55 |
| Item 6. <u>Exhibits</u> | 55 |
| <u>SIGNATURES</u> | 56 |
| <u>EXHIBIT INDEX</u> | 57 |

Table of Contents

AVAILABLE INFORMATION

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

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

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

Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****JMP Group Inc.****Consolidated Statements of Financial Condition****(Unaudited)**

| | September 30, 2009 | December 31, 2008 |
|--|-----------------------|-----------------------|
| Assets | | |
| Cash and cash equivalents | \$ 55,208,089 | \$ 46,261,959 |
| Restricted cash and deposits (includes cash on deposit with clearing broker of \$255,336 at September 30, 2009 and December 31, 2008) | 40,276,545 | 6,929,501 |
| Receivable from clearing broker | 2,452,590 | 1,878,078 |
| Investment banking fees receivable, net of allowance for doubtful accounts of \$0 and \$78,579 at September 30, 2009 and at December 31, 2008 | 5,674,562 | 1,647,761 |
| Marketable securities owned, at fair value | 18,282,610 | 19,838,480 |
| Incentive fee receivable | 553,162 | 1,479,741 |
| Other investments (of which \$56,703,393 and \$47,954,255 at fair value at September 30, 2009 and December 31, 2008) | 58,703,393 | 47,954,255 |
| Loans held for investment, net of allowance for loan losses | 1,692,036 | 5,725,867 |
| Loans collateralizing asset-backed securities issued, net of allowance for loan losses | 317,238,912 | |
| Interest receivable | 1,424,547 | 72,194 |
| Fixed assets, net | 1,247,806 | 1,207,014 |
| Deferred tax assets | 51,643,862 | 11,062,174 |
| Other assets | 5,615,152 | 8,789,068 |
| Total assets | \$ 560,013,266 | \$ 152,846,092 |
| Liabilities and Equity | | |
| Liabilities: | | |
| Marketable securities sold, but not yet purchased, at fair value | \$ 9,752,001 | \$ 5,677,683 |
| Accrued compensation | 33,956,459 | 21,349,724 |
| Asset-backed securities issued | 322,787,435 | |
| Interest payable | 611,073 | 17,663 |
| Note payable | 9,912,765 | 8,680,850 |
| Contingent consideration payable | 2,262,030 | |
| Deferred tax liability | 48,099,813 | 224,204 |
| Other liabilities | 11,911,288 | 3,823,892 |
| Total liabilities | 439,292,864 | 39,774,016 |
| Commitments and Contingencies | | |
| JMP Group Inc. Stockholders' Equity | | |
| Common stock, \$0.001 par value, 100,000,000 shares authorized; 22,069,741 shares issued at September 30, 2009 and December 31, 2008; 20,764,983 and 20,470,125 shares outstanding at September 30, 2009 and December 31, 2008 | 22,070 | 22,070 |
| Additional paid-in capital | 127,304,046 | 125,939,747 |
| Treasury stock (at cost, 1,304,758 and 1,599,616 shares at September 30, 2009 and December 31, 2008) | (8,604,003) | (10,710,981) |
| Accumulated deficit | (3,621,096) | (10,129,777) |

Edgar Filing: JMP Group Inc. - Form 10-Q

| | | |
|---|----------------|----------------|
| Total JMP Group Inc. stockholders' equity | 115,101,017 | 105,121,059 |
| Noncontrolling Interest | 5,619,385 | 7,951,017 |
| Total equity | 120,720,402 | 113,072,076 |
| Total liabilities and equity | \$ 560,013,266 | \$ 152,846,092 |

See accompanying notes to consolidated financial statements.

Table of Contents**JMP Group Inc.****Consolidated Statements of Operations****(Unaudited)**

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|-----------------------|---------------------------------|-----------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Revenues | | | | |
| Investment banking | \$ 10,390,644 | \$ 4,879,365 | \$ 25,103,996 | \$ 23,818,776 |
| Brokerage | 7,938,774 | 9,573,885 | 25,836,038 | 26,432,955 |
| Asset management fees | 3,266,493 | 2,292,014 | 15,765,626 | 6,364,634 |
| Principal transactions | 5,980,739 | (2,726,160) | 15,403,222 | (4,788,734) |
| Gain on sale and payoff of loans | 6,726,930 | | 11,571,062 | |
| Gain on repurchase of asset-backed securities issued | 4,096,473 | | 4,204,873 | |
| Gain on bargain purchase | | | 1,179,279 | |
| Net dividend income | 765,662 | 939,467 | 1,849,869 | 2,460,570 |
| Other income | 227,221 | 214,191 | 1,154,343 | 922,683 |
| Non-interest revenues | 39,392,936 | 15,172,762 | 102,068,308 | 55,210,884 |
| Interest income | 12,213,909 | 653,943 | 24,172,371 | 1,859,938 |
| Interest expense | (8,504,198) | (102,196) | (17,484,554) | (298,070) |
| Net interest income | 3,709,711 | 551,747 | 6,687,817 | 1,561,868 |
| Provision for loan losses | (1,383,650) | (427,882) | (5,365,842) | (427,882) |
| Total net revenues after provision for loan losses | 41,718,997 | 15,296,627 | 103,390,283 | 56,344,870 |
| Non-interest Expenses | | | | |
| Compensation and benefits | 29,308,305 | 17,724,046 | 70,848,981 | 44,147,847 |
| Administration | 1,098,179 | 1,257,487 | 3,541,203 | 4,610,307 |
| Brokerage, clearing and exchange fees | 1,316,800 | 1,389,384 | 4,056,799 | 3,859,357 |
| Travel and business development | 533,719 | 845,706 | 1,586,573 | 2,800,676 |
| Communications and technology | 989,175 | 912,043 | 2,807,552 | 2,911,598 |
| Occupancy | 610,091 | 478,316 | 1,787,608 | 1,426,135 |
| Professional fees | 899,268 | 636,005 | 2,782,855 | 2,512,950 |
| Depreciation | 188,789 | 239,909 | 592,422 | 760,797 |
| Other | 214,870 | 53,030 | 378,540 | 40,580 |
| Total non-interest expenses | 35,159,196 | 23,535,926 | 88,382,533 | 63,070,247 |
| Income (loss) before income tax expense | 6,559,801 | (8,239,299) | 15,007,750 | (6,725,377) |
| Income tax expense (benefit) | 2,879,018 | (2,971,386) | 6,491,386 | (2,485,284) |
| Net income (loss) | 3,680,783 | (5,267,913) | 8,516,364 | (4,240,093) |
| Less: Net income (loss) attributable to the noncontrolling interest | 712,007 | (369,208) | 1,227,459 | (214,658) |
| Net income (loss) attributable to JMP Group Inc. | \$ 2,968,776 | \$ (4,898,705) | \$ 7,288,905 | \$ (4,025,435) |
| Net income (loss) attributable to JMP Group Inc. per common share: | | | | |
| Basic | \$ 0.14 | \$ (0.24) | \$ 0.35 | \$ (0.20) |

Edgar Filing: JMP Group Inc. - Form 10-Q

| | | | | | | | | |
|---|----|------------|----|------------|----|------------|----|------------|
| Diluted | \$ | 0.13 | \$ | (0.24) | \$ | 0.34 | \$ | (0.20) |
| Weighted average common shares outstanding: | | | | | | | | |
| Basic | | 20,754,502 | | 20,035,637 | | 20,633,361 | | 20,317,627 |
| Diluted | | 22,014,723 | | 20,035,637 | | 21,640,249 | | 20,317,627 |

See accompanying notes to consolidated financial statements.

Table of Contents**JMP Group Inc.****Consolidated Statement of Changes in Equity****(Unaudited)**

| | JMP Group Inc. Stockholders Equity | | | | | | |
|---|------------------------------------|-----------|--------------------------|--------------------|------------------------|----------------------------|----------------|
| | Common Stock | | Treasury Stock Amount | Paid-In Capital | Accumulated Deficit | Noncontrolling Interest | Total Equity |
| | Shares | Amount | | | | | |
| Balance, December 31, 2008 | 22,069,741 | \$ 22,070 | \$ (10,710,981) | \$ 125,939,747 | \$ (10,129,777) | \$ 7,951,017 | \$ 113,072,076 |
| Net income | | | | | 7,288,905 | 1,227,459 | 8,516,364 |
| Additional paid-in capital - stock-based compensation | | | | (68,045) | | | (68,045) |
| Cash dividends paid to shareholders | | | | | (620,113) | | (620,113) |
| Purchases of shares of common stock for treasury | | | (1,108,592) | | | | (1,108,592) |
| Reissuance shares of common stock from treasury | | | 3,215,570 | 1,432,344 | (160,111) | | 4,487,803 |
| Sale of subsidiary shares to noncontrolling interest holders | | | | | | 373,705 | 373,705 |
| Reorganization of a subsidiary (Note 2) | | | | | | (3,932,796) | (3,932,796) |
| Balance, September 30, 2009 | 22,069,741 | \$ 22,070 | \$ (8,604,003) | \$ 127,304,046 | \$ (3,621,096) | \$ 5,619,385 | \$ 120,720,402 |

See accompanying notes to consolidated financial statements.

Table of Contents**JMP Group Inc.****Consolidated Statements of Cash Flows****(Unaudited)**

| | Nine Months Ended September 30, 2009 | 2008 |
|---|---|---------------------|
| Cash flows from operating activities: | | |
| Net income (loss) | \$ 8,516,364 | \$ (4,240,093) |
| Adjustments to reconcile net income to net cash (used in) provided by in operating activities: | | |
| Provision for doubtful accounts | | 468,462 |
| Provision for loan losses | 5,365,842 | |
| Amortization of deferred loan fees | (494,368) | (15,744) |
| Accretion of liquidity discount, net | 404,647 | |
| Loan origination and commitment fees | | 260,000 |
| Gain on sale and payoff of loans | (11,571,062) | |
| Gain on repurchase of asset-backed securities issued | (4,204,873) | |
| Change in other investments: | | |
| Fair value | (8,142,512) | 2,260,394 |
| Incentive fees reinvested in general partnership interests | (4,766,958) | (1,613,321) |
| Depreciation and amortization of fixed assets | 592,422 | 760,797 |
| Stock-based compensation expense | 3,901,127 | 6,588,432 |
| Deferred income taxes | 6,712,749 | (6,921,615) |
| Gain on bargain purchase | (1,179,279) | |
| Net change in operating assets and liabilities: | | |
| (Increase) in interest receivable | (215,457) | (62,157) |
| (Increase) decrease in receivables | (3,674,734) | 3,747,597 |
| (Increase) in marketable securities | (3,695,317) | (2,194,984) |
| (Increase) decrease in restricted cash (excluding restricted cash reserved for lending activities), deposits and other assets | (365,474) | 2,487 |
| Increase in marketable securities sold, but not yet purchased | 4,074,318 | 1,874,797 |
| (Decrease) in interest payable | (616,178) | |
| (Decrease) in securities sold under agreements to repurchase | | (9,135,000) |
| Increase (decrease) in accrued compensation and other liabilities | 18,993,722 | (16,355,197) |
| Net cash provided by (used in) operating activities | 9,634,979 | (24,575,145) |
| Cash flows from investing activities: | | |
| Purchases of fixed assets | (473,214) | (258,719) |
| Investment in subsidiary | (2,089,477) | (19,686,450) |
| Purchases of other investments | (7,486,372) | |
| Sales of other investments | 12,254,366 | 5,161,783 |
| Funding of loans collateralizing asset-backed securities issued | (93,558,772) | |
| Funding of loans held for investment | | (7,956,770) |
| Sale and refinancing of loans collateralizing asset-backed securities issued | 46,220,511 | |
| Principal payments on loans collateralizing asset-backed securities issued | 32,036,195 | |
| Principal payments on loans held for investment | 270,162 | 322,000 |
| Repayment of note receivable | | 335,272 |
| Net change in restricted cash reserved for lending activities | 14,674,980 | |
| Cash associated with consolidation / deconsolidation of investment | 902,475 | (4,726,076) |
| Net cash provided by (used in) investing activities | 2,750,854 | (26,808,960) |

Edgar Filing: JMP Group Inc. - Form 10-Q

| | | |
|---|--------------------|------------------|
| Cash flows from financing activities: | | |
| Proceeds from issuance of note payable | 6,100,000 | 8,680,850 |
| Repayment of note payable | (4,966,877) | |
| Net change in asset-backed securities issued | (3,227,371) | |
| Cash dividends paid to stockholders | (620,113) | (3,041,485) |
| Purchases of shares of common stock for treasury | (1,108,592) | (4,805,654) |
| Capital contributions of noncontrolling interest members and shareholders | 300,000 | 1,598,413 |
| Dividends paid to noncontrolling interest shareholders | | (224,254) |
| Proceeds from exercises of stock options | 83,250 | |
| Net cash (used in) provided by financing activities | (3,439,703) | 2,207,870 |
| | | |
| Net increase (decrease) in cash and cash equivalents | 8,946,130 | (49,176,235) |
| Cash and cash equivalents, beginning of period | 46,261,959 | 99,127,043 |
| | | |
| Cash and cash equivalents, end of period | \$ 55,208,089 | \$ 49,950,808 |
| | | |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for interest | \$ 4,253,526 | \$ 230,090 |
| Cash paid during the period for taxes | \$ 730,000 | \$ 6,348,719 |
| Non-cash investing and financing activities: | | |

The fair values of noncash assets acquired and liabilities assumed in the Cratos acquisition were \$376,371,923 and \$370,775,518, respectively.

On July 31, 2009, the Company received 100% of the membership interest in LSC III, LLC (LSC) in full satisfaction of a \$2.4 million non-revolving credit note.

See accompanying notes to consolidated financial statements.

Table of Contents

JMP GROUP INC.

Notes to Consolidated Financial Statements

September 30, 2009

(Unaudited)

1. Organization and Description of Business

JMP Group Inc., together with its subsidiaries (collectively, the Company), is an independent investment banking and asset management firm headquartered in San Francisco. JMP Group Inc. completed its initial public offering on May 16, 2007, and concurrently completed a corporate reorganization (the Reorganization), which is described in greater detail in the Registration Statement on Form S-1 (File No. 333-140689) (the Registration Statement) filed with the Securities and Exchange Commission (SEC) in connection with the initial public offering. The Company conducts its investment banking and brokerage business through its wholly-owned subsidiary, JMP Securities LLC (JMP Securities), its asset management business through its wholly-owned subsidiary, Harvest Capital Strategies LLC (HCS) (formerly JMP Asset Management LLC, which changed its name to HCS effective September 29, 2008) and its majority-owned indirect subsidiary, JMP Credit Corporation (JMP Credit), and certain principal investments through its indirectly wholly-owned subsidiary JMP Capital LLC (JMP Capital). JMP Securities is a U.S. registered broker-dealer under the Securities Exchange Act of 1934, as amended, and is a member of the Financial Industry Regulatory Authority (FINRA). JMP Securities operates as an introducing broker and does not hold funds or securities for, or owe any money or securities to, customers and does not carry accounts for customers. All customer transactions are cleared through another broker-dealer on a fully disclosed basis. HCS is a registered investment advisor under the Investment Advisers Act of 1940, as amended, and provides investment management services for sophisticated investors in investment partnerships and other entities managed by HCS.

Effective April 7, 2009, the Company, through its majority-owned indirect subsidiary JMP Credit, completed the acquisition of 100% of the membership interests of Cratos Capital Partners, LLC and its subsidiaries, including Cratos Capital Management, LLC (collectively, Cratos), an alternative asset manager of collateralized loan obligations, together with certain securities of Cratos CLO I, Ltd. (the CLO). Certain members of Cratos hold noncontrolling interests in JMP Credit. As a result of the acquisition, the Company now operates in three reportable business segments: 1) Broker-Dealer, 2) Asset Management and 3) Corporate Credit. Please refer to Note 4 and Note 23 for further information on the acquisition and our business segments.

2. Summary of Significant Accounting Policies

Basis of Presentation

These consolidated financial statements and related notes are unaudited and have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. These consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto for the year ended December 31, 2008 included in its annual report on Form 10-K. These consolidated financial statements reflect all adjustments (consisting only of normal recurring adjustments) that are, in the opinion of management, necessary for the fair statement of the results for the interim periods. The results of operations for any interim period are not necessarily indicative of the results to be expected for a full year.

The consolidated accounts of the Company include the wholly-owned subsidiaries, JMP Securities and HCS, the indirectly wholly-owned subsidiary, JMP Capital, and the partially-owned subsidiaries, JMP Credit, Harvest Mortgage Opportunities Partners HMOP (effective May 1, 2009), JMP Realty Trust, Inc. JMPRT (through December 31, 2008), Harvest Consumer Partners HCP (through November 30, 2008), Harvest Technology Partners HTP (through July 31, 2008) and Opportunity Acquisition Corp., a special purpose acquisition corporation, or SPAC, formed for the purpose of acquiring one or more businesses through a merger, capital stock exchange, stock purchase, asset acquisition, or other similar business combination. The Company is the sponsor of the SPAC. All material intercompany accounts and transactions have been eliminated in consolidation.

Noncontrolling interest on the consolidated statements of financial condition at September 30, 2009 relates to the interest of third parties in JMP Credit, HMOP and SPAC, partially-owned subsidiaries consolidated on our books. Noncontrolling interest on the consolidated statements of financial condition at December 31, 2008 relates to the interest of third parties in JMPRT and SPAC.

The Company follows the authoritative guidance included in Generally Accepted Accounting Principles (GAAP) on accounting for consolidation of variable interest entities (VIEs). Such guidance applies to certain entities (called VIEs) in which equity investors do not have

Edgar Filing: JMP Group Inc. - Form 10-Q

the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. When the Company enters into a transaction with a VIE, the Company determines if it is the primary beneficiary of the VIE by performing a qualitative analysis of the VIE that includes a review of, among other factors, its capital structure, contractual terms, related party relationships, the Company's fee arrangements and the design of the VIE. Upon acquisition of Cratos, the Company performed this analysis and concluded that the CLO managed by Cratos is a VIE and that Cratos Capital Partners LLC, which owns 100% of the subordinated notes in the CLO and performs ongoing management responsibilities for the CLO, is deemed the primary beneficiary. As a result, the Company consolidates the assets and liabilities of the Cratos CLO securitization entity, and the underlying loans owned by the CLO entity are shown on our consolidated statements of financial condition under loans collateralizing asset-backed securities issued and the asset-backed securities (ABS) issued to third parties are shown under ABS issued.

JMPRT is a real estate investment trust that was formed in June 2006. As of December 31, 2008, the Company owned 49.5% of JMPRT and certain employees owned 20.1%. Because of its ownership and management position, the Company consolidated JMPRT and recorded a noncontrolling interest through December 31, 2008. On January 2, 2009, all of the assets and liabilities within JMPRT were transferred to HMOP, a hedge fund managed by HCS. HMOP is a Delaware limited partnership organized for the purposes of investing in real estate-related assets which may include investments in residential or commercial mortgages or loans, real estate and other assets, loans and participation in loans of all types, other specialty mortgage products, and securities. HCS is the general partner of HMOP. In connection with the above asset and liability transfer, the Company exchanged its interest in JMPRT for an interest in HMOP. No gain or loss was recognized from this exchange. The Company follows the authoritative

Table of Contents

guidance under GAAP regarding the determination of 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. Such guidance applies when a general partner controls a limited partnership and is required to consolidate the limited partnership in its financial statements. Under the guidance, the general partner in a limited partnership is presumed to control the limited partnership regardless of the extent of the general partners' ownership interest in the limited partnership. If the limited partners have either (a) the substantive ability to liquidate the limited partnership or otherwise remove the general partner without cause or (b) substantive participating rights, the general partner does not control the limited partnership. The partnership agreements for HMOP provide for the right of the limited partners to remove the general partner by a simple majority vote of the non-affiliated limited partners. Because of these substantive kick-out rights, the Company, as the general partner, did not control HMOP and therefore did not consolidate HMOP from January 2, 2009 through April 30, 2009. During the quarter ended June 30, 2009, several non-affiliated limited partners redeemed their interest in HMOP, and the remaining limited partners were no longer deemed to have substantive kick-out rights. As a result, the Company consolidates HMOP in its consolidated financial statements effective May 1, 2009. The change in noncontrolling interest as a result of the transfer of assets and liabilities from JMPRT to HMOP and the consolidation of HMOP is presented as a reorganization of a subsidiary in our Consolidated Statement of Changes in Equity.

HCP had been consolidated in the Company's financial statements, with a noncontrolling interest being recorded, since its inception in January 2006 through November 30, 2008, due to the Company's and related parties' ownership and resulting control of HCP. As a result of the admission of additional non-affiliated limited partners, effective December 1, 2008 HCP was deconsolidated from the Company's financial statements and the investment in HCP is accounted for under the equity method of accounting.

HTP had been consolidated in the Company's financial statements, with a noncontrolling interest being recorded, since its inception in January 2006 through July 31, 2008, due to the Company's and related parties' ownership and resulting control of HTP. As a result of the admission of additional non-affiliated limited partners, effective August 1, 2008 HTP was deconsolidated from the Company's financial statements and the investment in HTP is accounted for under the equity method of accounting.

In addition to HTP and HCP, HCS currently manages several other asset management limited partnerships and is a general partner of each. The partnership agreements for these asset management funds provide for the right of the limited partners to remove the general partners by a simple majority vote of the non-affiliated limited partners. Because of these substantive kick-out rights, the Company, as the general partner, does not control these asset management funds and therefore does not consolidate those funds.

On January 18, 2008, JMP Group Inc. and certain unconsolidated affiliates made an investment in convertible preferred stock of New York Mortgage Trust, Inc. (NYMT), a publicly traded real estate investment trust engaged in the investment management of mortgage-backed securities and high credit quality residential adjustable rate mortgage loans. Such investment by JMP Group Inc. and affiliated entities was \$20.0 million in total, comprised of \$5.0 million by JMP Group Inc., \$5.0 million by certain funds managed by HCS, and \$10.0 million from JMPRT. JMPRT's investment in NYMT was transferred to HMOP on January 2, 2009. In addition, JMP Group Inc. invested \$4.5 million in the common stock of NYMT on February 14, 2008 via a private investment in public equity (PIPE) transaction. At September 30, 2009, JMP Group Inc. owned approximately 6.3% of NYMT's common stock. In addition, JMP Group Inc. and affiliated entities collectively owned 1.0 million shares of NYMT's Series A Preferred Stock at September 30, 2009. The Series A Preferred Stock is convertible into shares of NYMT's common stock based on a conversion price of \$8.00 per share of common stock, which represents a conversion rate of two and one-half (2 1/2) shares of common stock for each share of Series A Preferred Stock. The Series A Preferred Stock matures on December 31, 2010, at which time any outstanding shares must be redeemed by NYMT at the \$20.00 per share liquidation preference. Because of its current ownership and management position, the Company does not consolidate NYMT. The Company accounts for its investment in NYMT using the fair value option in accordance with the authoritative guidance included in GAAP on financial instruments. See Note 24 for the summarized financial information of NYMT.

On July 31, 2009, the Company received 100% of the membership interest in LSC III, LLC (LSC) in full satisfaction of a \$2.4 million non-revolving credit note. LSC is an investment partnership and owns shares of common and preferred stock of two privately-held companies which had an aggregate fair value of \$2.4 million at September 30, 2009. The Company is the sole member of LSC and therefore has a controlling financial interest in LSC. As a result, the Company consolidates LSC in its consolidated financial statements effective July 31, 2009.

Use of Estimates

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

Revenue Recognition

Investment Banking Revenues

Investment banking revenues consist of underwriting revenues, strategic advisory revenues and private placement fees, and are recorded when the underlying transaction is completed under the terms of the relevant agreement. Underwriting revenues arise from securities offerings in which the Company acts as an underwriter and include management fees, selling concessions and underwriting fees, net of related syndicate expenses. Management fees and selling concessions are recorded on the trade date, which is typically the day of pricing an offering (or the following day) and underwriting fees, net of related syndicate expenses, at the time the underwriting is completed and the related income is reasonably determinable. For these transactions, management estimates the Company's share of the transaction-related expenses incurred by the syndicate, and recognizes revenues net of such expense. On final settlement, typically 90 days from the trade date of the transaction, these amounts are adjusted to reflect the actual transaction-related expenses and the resulting underwriting fee. Expenses associated with such transactions are deferred until the related revenue is recognized or the engagement is otherwise concluded. If management determines that a transaction is likely not to be completed, deferred expenses related to that transaction are expensed at that time. Strategic advisory revenues primarily include success fees on closed merger and acquisition

Table of Contents

transactions, as well as retainer fees, earned in connection with advising on both buyers and sellers transactions. Fees are also earned for related advisory work and other services such as providing fairness opinions and valuation analyses. Strategic advisory revenues are recorded when the transactions or the services (or, if applicable, separate components thereof) to be performed are substantially complete, the fees are determinable and collection is reasonably assured. Private placement fees are related to non-underwritten transactions such as private placements of equity securities, private investments in public equity (PIPE), Rule 144A private offerings and trust preferred securities offerings and are recorded on the closing date of the transaction. Unreimbursed expenses associated with strategic advisory and private placement transactions, net of client reimbursements, are recorded in the Consolidated Statements of Operations within various expense captions other than compensation expense.

Brokerage Revenues

Brokerage revenues consist of (i) commissions resulting from equity securities transactions executed as agent or principal and are recorded on a trade date basis, (ii) related net trading gains and losses from market making activities and from the commitment of capital to facilitate customer orders and (iii) fees paid for equity research. The Company currently generates revenues from research activities through three types of arrangements. First, through what is commonly known as a soft dollar practice, a portion of a client's commissions may be compensation for the value of access to our research. Those commissions are recognized on a trade date basis, as the Company has no further obligation. Second, a client may issue a cash payment directly to the Company for access to research. Third, the Company has entered into certain commission-sharing or tri-party arrangements in which institutional clients execute trades with a limited number of brokers and instruct those brokers to allocate a portion of the commission to the Company or to issue a cash payment to the Company. In these commission-sharing or tri-party arrangements, the amount of the fee is determined by the client on a case-by-case basis and agreed to by the Company. An invoice is then sent to the payor. For the second and third type of arrangements, revenue is recognized and an invoice is sent once an arrangement exists, access to research has been provided, a specific amount is fixed or determinable, and collectibility is reasonably assured. None of these arrangements obligate clients to a fixed amount of fees for research, either through trading commissions or direct or indirect cash payments, nor do they obligate the Company to provide a fixed quantity of research or execute a fixed number of trades. Furthermore, the Company is not obligated under any arrangement to make commission payments to third parties on behalf of clients.

Asset Management Fees

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

Principal Transactions

Principal transaction revenues include realized and unrealized net gains and losses resulting from our principal investments in equity and other securities for the Company's account and in equity-linked warrants received from certain investment banking assignments, as well as limited partner investments in private funds managed by third parties and our investment in NYMT. Principal transaction revenues also include earnings (or losses) attributable to investment partnership interests held by our asset management subsidiary, HCS, which are accounted for using the equity method of accounting.

The Company's principal transaction revenues for these categories for the three and nine months ended September 30, 2009 and 2008 are as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------|----------------------------------|----------------|---------------------------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| Equity and other securities | \$ 4,893,771 | \$ (3,197,777) | \$ 9,389,771 | \$ (6,028,823) |
| Investment partnerships | 1,103,317 | 525,545 | 6,104,833 | 1,140,433 |

Edgar Filing: JMP Group Inc. - Form 10-Q

| | | | | |
|--------------------------------------|--------------|----------------|---------------|----------------|
| Warrants and other investments | (16,349) | (53,928) | (91,382) | 99,656 |
| Total principal transaction revenues | \$ 5,980,739 | \$ (2,726,160) | \$ 15,403,222 | \$ (4,788,734) |

Edgar Filing: JMP Group Inc. - Form 10-Q

Gain on Sale and Payoff of Loans

Gain on sale and payoff of loans consists of gains from the sale and payoff of loans collateralizing asset backed securities at JMP Credit Corporation. Gains are recorded when the proceeds exceed our carrying value of the loan.

Gain on Repurchase of Asset-Backed Securities Issued

Gain on repurchase of asset-backed securities issued consists of gains from repurchases of our ABS from third parties. Gains are recorded when the repurchase price is less than the carrying value of the ABS.

Table of Contents*Gain on Bargain Purchase*

A bargain purchase gain was recognized upon the acquisition of Cratos by JMP Credit Corporation on April 7, 2009. This represents the difference between the fair value of net assets acquired and the consideration to the sellers.

Interest Income

Interest income primarily relates to income earned on loans. Interest income on loans comprises the stated coupon as a percentage of the face amount receivable as well as accretion of accretable or purchase discounts and deferred fees and costs, see Loans held for investment and Loans collateralizing asset-backed securities issued for more information. Interest income is recorded on the accrual basis in accordance with the terms of the respective loans unless such loans are placed on non-accrual status.

Interest Expense

Interest expense primarily relates to expense incurred on asset-backed securities issued and note payable. Interest expense on asset-backed securities issued is the stated coupon as a percentage of the principal amount payable as well as amortization of liquidity discount which was recorded at the acquisition date of Cratos, see asset-backed securities issued for more information. Interest expense is recorded on the accrual basis in accordance with the terms of the respective asset-backed securities issued and note payable.

Cash and Cash Equivalents

The Company considers highly liquid investments with original maturities or remaining maturities upon purchase of three months or less to be cash equivalents. The Company holds cash in financial institutions in excess of the FDIC insured limits. The Company periodically reviews the financial condition of these financial institutions and assesses the credit risk.

Restricted Cash and Deposits

Restricted cash and deposits include principal and interest payments that are collateral for the asset-backed securities issued by Cratos. They also include proceeds from short sales deposited with brokers that cannot be removed unless the securities are delivered, cash collateral supporting standby letters of credit issued by JMP Credit, cash on deposit for operating leases, and cash on deposit with JMP Securities clearing broker.

Restricted cash consisted of the following at September 30, 2009 and December 31, 2008:

| | September 30, 2009 | December 31, 2008 |
|---|--------------------|-------------------|
| Principal and interest payments held as collateral for asset-backed securities issued | \$ 27,204,583 | \$ |
| Cash collateral supporting standby letters of credit | 1,309,083 | |
| Proceeds from short sales | 10,869,072 | 5,677,682 |
| Deposit with clearing broker | 255,336 | 255,336 |
| Deposits for operating leases | 638,471 | 996,483 |
| | \$ 40,276,545 | \$ 6,929,501 |

Receivable from Clearing Broker

The Company clears customer transactions through another broker-dealer on a fully disclosed basis. At September 30, 2009 and December 31, 2008, the receivable from clearing broker consisted solely of commissions related to securities transactions.

Investment Banking Fees Receivable

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

Fair Value of Financial Instruments

The Company adopted amended accounting principles related to fair value measurements as of January 1, 2008. The amendment establishes a consistent framework for measuring fair value in accordance with generally accepted accounting principles (GAAP) and expands disclosures with respect to fair value measurements. The amendment applies to all financial instruments that are being measured and reported on a fair value basis. This includes those items currently reported in marketable securities owned, at fair value, other investments and marketable securities sold, not yet purchased, at fair value on the consolidated statements of financial condition. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See Note 5 of the Notes to the consolidated financial statements for the disclosures related to the fair value of our marketable securities and other investments.

Most of the Company's financial instruments, other than loans collateralizing asset-backed securities issued, loans held for investment, asset-backed securities issued and investment in HuaMei Capital Company, Inc., are recorded at fair value or amounts that approximate fair value. In February 2009, the Company made a \$2.0 million investment in HuaMei Capital Company, Inc. (HuaMei) to expand its investment banking capabilities in China. HuaMei is a joint venture of China Merchants Securities; MVC Capital, Inc., a publicly traded business development company managed by The Tokarz Group Advisers LLC; and HuaMei Capital founders. The Company accounts for its investment in HuaMei under the equity method of accounting.

Table of Contents

Marketable securities owned, Other investments, excluding investment in HuaMei Capital Company, Inc., and Marketable securities sold, but not yet purchased, are stated at fair value, with related changes in unrealized appreciation or depreciation reflected in the line item Principal transactions in the accompanying Consolidated Statements of Operations.

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

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

Also included in other investments are convertible preferred stock of NYMT, and warrants on public and private common stock. The investment in NYMT convertible preferred stock is based on a fair value estimate using the Black-Scholes credit adjusted valuation model on Bloomberg. The warrants on public and private common stock are generally received as a result of investment banking transactions and are valued at estimated fair value as determined by management. Warrants owned are valued at the date of issuance and marked-to-market as of each reporting period. Estimated fair value is determined using the Black-Scholes Options Valuation methodology adjusted for active market and other considerations on a case-by-case basis.

The Company follows the authoritative guidance included in GAAP on the fair value option which provides companies with an option to report selected financial assets and financial liabilities at fair value. It requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The election to use the fair value option is available at specified election dates, such as when an entity first recognizes a financial asset or financial liability or upon entering into a firm commitment. Subsequent changes in fair value must be recorded in the Consolidated Statements of Operations. Additionally, the authoritative guidance allows for a one-time election for existing positions upon adoption, with the transition adjustment recorded to beginning retained earnings.

We elected to apply the fair value option to the following financial assets:

Investment in NYMT convertible preferred stock; and

Investment in NYMT common stock

Dividends received during the three months ended September 30, 2009 and 2008 on NYMT stock of \$0.5 million and \$0.5 million, respectively, were recorded in net dividend income on our Consolidated Statements of Operations. Dividends received during the nine months ended September 30, 2009 and 2008 on NYMT stock of \$1.3 million and \$1.3 million, respectively, were recorded in net dividend income on our Consolidated Statements of Operations. During the three and nine months ended September 30, 2009, the Company recorded unrealized gains of \$2.3 million and \$5.6 million, respectively, on the above investments in NYMT primarily due to the improved performance of NYMT's stock during the period. The unrealized gains on our investments in NYMT are reported in Principal Transactions in the Consolidated Statements of Operations.

Loans Held for Investment

Loans held for investment are carried at their unpaid principal balance, net of any allowance for credit losses or deferred loan origination or commitment fees. For loans held for investment, we establish and maintain an allowance for credit losses based on management's estimate of credit losses in our loans as of each reporting date. The Company records the allowance against loans held for investment on a specific identification basis. Loans are charged off against the reserve for credit losses if the principal is deemed not recoverable within a reasonable timeframe. Loan origination and commitment fees are deferred and recognized into Interest income in the Consolidated Statements of Operations over the life of the related loan. The Company does not accrue interest on loans which are in default for more than 90 days and loans which we expect full principal payments may not be received.

Loans Collateralizing Asset-Backed Securities Issued

Loans collateralizing asset-backed securities issued are commercial loans securitized and owned by the Cratos CLO. The loans consist of those loans within the CLO securitization structure at the acquisition date of Cratos and loans purchased or originated into the CLO subsequent to the Cratos acquisition date.

Table of Contents

Loans acquired through the acquisition and resulting consolidation of Cratos were recorded at their fair value as of the acquisition date. Any unamortized deferred fees or costs related to the loans that existed prior to the acquisition were written off at that date.

For those loans deemed impaired as of the date of the acquisition, the total discount from outstanding principal balance to fair value consists of a nonaccretable credit discount and in most cases an accretable liquidity (or market value) discount. For the remaining loans acquired through the purchase of Cratos, any discounts to fair value were recorded as accretable liquidity discounts as they were not attributable to credit quality. For both types of loans, the accretable portion of the discount is recognized into interest income as an adjustment to the yield of the loan over the contractual life of the loan using the interest method.

The Company continues to estimate the cash flows expected to be collected over the life of the loans acquired through the purchase of Cratos. If, upon subsequent evaluation, the Company believes it is unable to collect all cash flows expected at the acquisition date plus additional cash flows expected to be collected arising from changes in estimate after the acquisition, the loan is considered impaired for purposes of applying the authoritative guidance under GAAP on loss contingencies or, if applicable, the authoritative guidance under GAAP on loan impairment. Loans considered impaired at the acquisition date of Cratos continue to be assessed in accordance with the authoritative guidance under GAAP on loan impairment. If based on current information and events, it is probable that there is a significant increase in cash flows previously expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, the Company will first reduce any remaining credit discounts (including allowances for loan losses) and, to the extent necessary, any liquidity discounts for the loans established after its acquisition for the increase in the present value of cash flows expected to be collected. Then the Company will recalculate the amount of accretable yield for the loan as the excess of the revised cash flows expected to be collected over the sum of (a) the initial investment less (b) cash collected less (c) write-downs plus (d) amount of yield accreted to date. The Company will adjust the amount of accretable yield by reclassification from nonaccretable discount. The adjustment is accounted for as a change in estimate, with the amount of periodic accretion adjusted over the remaining life of the loan. The resulting yield is then used as the effective interest rate in any subsequent accounting.

Loans purchased or originated after the acquisition date of Cratos are stated at the principal amount outstanding net of deferred fees, deferred costs and the allowance for loan losses. Net deferred fees or costs are recognized as an adjustment to interest income over the contractual life of the loans using the interest method. Remaining amounts are recognized into income when the related loans are paid off or sold. Any discount from principal amount of purchased loans is accreted into interest income as a yield adjustment over the contractual life of the loan.

The accrual of interest on loans is discontinued when principal or interest payments are 90 days or more past due or when, in the opinion of management, reasonable doubt exists as to the full collection of principal and/or interest. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Any reversals of income from previous years are recorded against the allowance for loan losses. When the Company receives a cash interest payment on a non-accrual loan, it is applied as a reduction of the principal balance. Non-accrual loans are returned to accrual status when the borrower becomes current as to principal and interest and has demonstrated a sustained period of payment performance. The amortization of loan fees is discontinued on nonaccrual loans and may be considered for write-off. Depending on the terms of the loan, a fee may be charged upon a prepayment which is recognized in the period of the prepayment. Syndication and structuring fees are recognized in the period the service is completed as other income.

Allowance for Loan Losses

The Company maintains an allowance for loan losses that is intended to estimate loan losses inherent in its loan portfolio. A provision for loan losses is charged to expense to establish the allowance for loan losses. The allowance for loan losses is maintained at a level, in the opinion of management, sufficient to off set estimated losses inherent in the loan portfolio as of the date of the financial statements. The appropriateness of the allowance and the allowance components are reviewed quarterly. The Company's estimate of each allowance component is based on observable information and on market and third party data that the Company believes are reflective of the underlying loan losses being estimated.

In accordance the authoritative guidance under GAAP on loan impairment, the Company first provides an allowance for loans that are considered impaired. A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company measures impairment of a loan based upon either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral securing the loan if the loan is collateral dependent, depending on the circumstances and the Company's collection strategy. For those loans held by Cratos at the date of acquisition by JMP Credit, and deemed impaired at that date or a subsequent date, allowance for loan losses is calculated considering two further factors. For loans deemed impaired at the date of acquisition if there is a further decline in expected future cash flows, this reduction is recognized as a specific reserve in the current quarter in accordance with above. For those loans deemed impaired subsequent to the acquisition date, if the net realizable value is lower than the current carrying value then the carrying value is reduced and the difference is booked as provision for loan losses. If the total discount from unpaid principal balance to carrying value is larger than the expected loss at the date of assessment, no provision for loan losses is recognized.

Edgar Filing: JMP Group Inc. - Form 10-Q

In addition, in accordance with the authoritative guidance under GAAP on loss contingencies, the Company provides an allowance on a loan by loan basis for loans at JMP Credit that are not impaired and were purchased after the Cratos acquisition. The Company employs internally developed and third party estimation tools for measuring credit risk (loan ratings, probability of default, and exposure at default), which are used in developing an appropriate allowance for loan losses. The Company performs periodic detailed reviews of its loan portfolio to identify risks and to assess the overall collectibility of loans.

Loans which are deemed to be uncollectible are charged off and the charged-off amount is deducted from the allowance.

Asset-Backed Securities Issued

Asset-backed securities (ABS) represent securities issued to third parties from the CLO when the CLO structure formed in 2007. The Company consolidates the CLO for financial reporting purposes as of the April 7, 2009 acquisition date. At the acquisition date, the ABS were recorded at fair value which comprised principal balance outstanding less liquidity discount. The liquidity discount will be amortized into interest expense over the expected remaining lives of the ABS using the interest method.

Table of Contents

Fixed Assets

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

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

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

Income Taxes

The Company accounts for income taxes in accordance with the authoritative guidance under GAAP on income taxes which requires the recognition of deferred tax assets and liabilities based upon the temporary differences between the financial reporting and tax bases of the assets and liabilities. Valuation allowances are established when necessary to reduce the deferred tax assets when it is more likely than not that a portion or all of the deferred tax assets will not be realized.

The Company adopted the accounting principles related to uncertainty in income taxes on May 16, 2007, the date the Company became subject to federal and state income taxes. Its adoption did not have a material impact on the Company's financial condition or results of operations. Under the guidance, the Company recognizes a tax benefit from an uncertain position only if it is more likely than not that the position is sustainable, based solely on its technical merits and consideration of the relevant taxing authority's widely understood administrative practices and precedents. If this threshold is met, the Company measures the tax benefit as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement.

For the three and nine months ended September 30, 2009 and 2008, income taxes are computed based on actual results.

Stock-Based Compensation

Effective January 1, 2006, the Company adopted the amended accounting principles related to stock-based compensation, using the modified prospective method. Under that method of adoption, the amended accounting principles are generally only applied to share-based awards granted subsequent to adoption. The amended accounting principles requires measurement of compensation cost for stock-based awards classified as equity at their fair value on the date of grant and the recognition of compensation expense over the service period for awards expected to vest. Such grants are recognized as expense over the service period, net of estimated forfeitures.

Stock-based compensation includes restricted stock units and stock options granted under the Company's 2007 Equity Incentive Plan, and stock options granted under the Company's 2004 Equity Incentive Plan.

In accordance with generally accepted valuation practices for stock-based awards issued as compensation, the Company uses the Black-Scholes option-pricing model to calculate the fair value of option awards, although such models were originally developed to estimate the fair value of freely tradable, fully transferable options without vesting restrictions, which significantly differ from the Company's stock options and restricted stock units. The Black-Scholes model requires subjective assumptions regarding variables such as future stock price volatility, dividend yield and expected time to exercise, which greatly affect the calculated values.

Treasury Stock

We account for treasury stock under the cost method, using an average cost flow assumption, and we include treasury stock as a component of stockholders' equity.

Reclassification

Certain balances from prior years have been reclassified in order to conform to the current year presentation. The reclassifications had no impact on the Company's financial position, net income or cash flows. Please see Note 23 for the effect of reclassifications on segments.

3. Recent Accounting Pronouncements

Accounting Standards Update (ASU) No. 2009-05, *Fair Value Measurements and Disclosures - Measuring Liabilities at Fair Value*, (ASU 2009-05). In August 2009, the FASB issued ASU 2009-05 which provides amendments to ASC 820-10, *Fair Value Measurements and Disclosures - Overall*, for the fair value measurement of liabilities. ASU 2009-05 provides clarification on the valuation techniques that should be used in circumstances in which a quoted price in an active market for the identical liability is not available. It also clarifies certain other requirements in ASC 820-10 when estimating the fair value of a liability. ASU 2009-05 is effective for the first reporting period beginning after August 27, 2009. The Company will adopt ASU 2009-05 for the three-month period ending December 31, 2009. The Company does not expect the adoption to have a material impact on our consolidated financial position or results of operations.

Table of Contents

ASU No. 2009-06, *Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities*, (ASU 2009-06). In September 2009, the FASB issued ASU 2009-06 which provides additional implementation guidance on accounting for uncertainty in income taxes. It also amends certain disclosure requirements for nonpublic entities. ASU 2009-06 is effective for the reporting period beginning after September 15, 2009 for entities that are currently applying the standards for accounting for uncertainty in income taxes. The Company's adoption of ASU 2009-06 for the three-month period ended September 30, 2009 did not have an impact on our consolidated financial position or results of operations.

ASU No. 2009-12, *Fair Value Measurements and Disclosures - Investments in Certain Entities that Calculate Net Asset Per Share (or Equivalent)*, (ASU 2009-12). In September 2009, the FASB issued ASU 2009-12 which provides amendments to ASC 820-10, *Fair Value Measurements and Disclosures - Overall*, to provide guidance on the fair value measurement of investments in certain entities that calculate net asset value per share (or its equivalent). ASU 2009-12 is effective for the interim and annual period ending after December 31, 2009. The Company will adopt ASU 2009-12 for the three-month period ending December 31, 2009. The Company does not expect the adoption to have a material impact on our consolidated financial position or results of operations.

In June 2009, the FASB issued SFAS No. 167, *Amendments to FASB Interpretation No. 46(R)* (SFAS No. 167), which amends the consolidation guidance for variable interest entities under FIN 46(R). The key amendments include (1) the elimination of the exemption for qualifying special purpose entities, (2) a new approach for determining who should consolidate a variable-interest entity, and (3) changes to when it is necessary to reassess who should consolidate a variable-interest entity. SFAS No. 167 is effective for the beginning of an entity's first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter.

The Company is currently evaluating SFAS 167 and has not yet determined the impact on our consolidated financial position or results of operations. However, the Company currently does not consolidate hedge funds it manages where there are substantive kick-out rights that can remove the general partner by a simple majority vote of the non-affiliated limited partners. The implementation of SFAS 167 by the Company on January 1, 2010 may require the consolidation of these hedge funds. See Note 24 for further information on our hedge funds.

SFAS No. 166, *Accounting for Transfers of Financial Assets an amendment of SFAS No. 140*, (SFAS 166). In June 2009, the FASB issued SFAS 166 which amends SFAS No. 140 to remove the concept of a qualifying special-purpose entity and to remove the exception from applying FASB Interpretation (FIN) No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, (FIN 46R) to qualifying special-purpose entities. In addition, SFAS 166 defines the term participating interest to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. It also requires enhanced disclosures to provide financial statement users with greater transparency about transfers of financial assets and a transferor's continuing involvement with transferred financial assets. FAS 166 must be applied as of the beginning of the first annual reporting period that begins after November 15, 2009, for interim periods within that first annual reporting period and for interim and annual reporting periods thereafter. The Company will adopt SFAS 166 for the three-month period ending March 31, 2010. The Company does not expect the adoption to have an impact on our consolidated financial position or results of operations.

In June 2009, the FASB issued FASB ASC 105-10, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, (formerly SFAS 168). FASB ASC 105-10 replaces the SFAS 162, *The Hierarchy of Generally Accepted Accounting Principles*, and establishes the FASB Accounting Standards Codification (Codification) as the source of authoritative accounting principles recognized by the FASB to be applied by non-governmental entities in the preparation of financial statements in conformity with GAAP. The Codification became the exclusive authoritative reference at September 30, 2009. Updates to the Codification Standards are issued as Accounting Standard Updates (ASU s) by the FASB. The Company's adoption of the Codification for the three-month period ended September 30, 2009 did not have an impact on our consolidated financial position or results of operations.

4. Acquisition

Effective April 7, 2009, the Company, through its majority-owned indirect subsidiary JMP Credit, completed the acquisition of 100% of the membership interests of Cratos Capital Partners, LLC and its subsidiaries, including Cratos Capital Management, LLC (collectively, Cratos), an alternative asset manager of collateralized loan obligations, together with 100% of the subordinated securities of Cratos CLO I, Ltd. (the CLO). The results of operations of Cratos from April 7, 2009 to September 30, 2009 have been included in the statement of operations of the Company for the three and nine months ended September 30, 2009. The CLO was, at the acquisition date, a diversified portfolio of approximately \$467 million par amount of first lien corporate loans for which Cratos serves as investment adviser. The Company acquired control of Cratos through acquiring Cratos Capital Partners LLC (which holds the subordinated securities) with the intent of expanding its business in alternative asset management.

Table of Contents

The acquisition was accounted for under the acquisition method of accounting, which requires the purchase price to be allocated to assets and liabilities based on their estimated fair value at the acquisition date. The consideration for the net assets acquired was concluded upon prior to the assessment of the fair value of the net assets at the acquisition date. Therefore, the excess of the value of the net assets acquired over the purchase price was recorded as gain on bargain purchase and is shown as a separate component of revenues in the Company's Consolidated Statement of Operations for the three months ended June 30, 2009 and the nine months ended September 30, 2009. The following table represents the allocation of the purchase price to the acquired net assets and resulting gain on bargain purchase:

| | |
|---|-----------------------|
| Amount of cash paid | \$ 4,000,000 |
| Fair value of contingent consideration (Note 10) | 2,253,944 |
| Discount on noncontrolling interest | 73,705 |
| Total purchase price | 6,327,649 |
| Allocation of the purchase price | |
| Cratos member's deficit | (13,595,538) |
| Pre-tax adjustments to reflect assets and liabilities at fair value: | |
| Loans collateralizing asset-backed securities issued | (113,224,756) |
| Fixed assets | (34,252) |
| Deferred financing costs | (6,881,314) |
| Other assets | (54,916) |
| Accrued interest payable | 7,180 |
| Asset-backed securities issued | 138,399,679 |
| Pre-tax total adjustments | 18,211,621 |
| Deferred income taxes | (581,172) |
| After tax total adjustments | 17,630,449 |
| Other acquisition adjustments | |
| Contingent liability to seller (Note 10) | (2,253,944) |
| Working capital line payoff | 5,799,666 |
| Noncontrolling interest at fair value | (73,705) |
| Fair value of net assets acquired | 7,506,928 |
| Bargain purchase gain resulting from Cratos acquisition | \$ (1,179,279) |

The following condensed statement of net assets acquired reflects the fair values assigned to the assets and liabilities of Cratos as of the acquisition date:

| | |
|--|----------------|
| Assets: | |
| Cash and cash equivalents | \$ 1,910,523 |
| Restricted cash and deposits | 44,359,080 |
| Loans collateralizing asset-backed securities issued | 280,499,632 |
| Interest receivable | 1,136,896 |
| Deferred tax asset | 50,121,928 |
| Other assets | 254,387 |
| Total assets | \$ 378,282,446 |

Liabilities:

Edgar Filing: JMP Group Inc. - Form 10-Q

| | |
|------------------------------------|----------------|
| Asset-backed securities issued | \$ 316,513,000 |
| Interest payable | 1,209,588 |
| Other liabilities | 2,349,830 |
| Deferred tax liability | 50,703,100 |
| Total liabilities | \$ 370,775,518 |
| Net assets acquired, at fair value | \$ 7,506,928 |

Table of Contents

The following unaudited pro forma condensed combined statements of income present the combined results of the Company's operations with Cratos as if the acquisition had occurred on January 1, 2008.

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|---------------|---------------------------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| Pro forma revenues | \$ 41,718,997 | \$ 16,221,219 | \$ 102,324,260 | \$ 66,650,401 |
| Pro forma net income | 2,968,776 | (5,972,013) | 5,485,601 | (2,898,184) |
| Pro forma net income per share - basic | \$ 0.14 | \$ (0.30) | \$ 0.27 | \$ (0.14) |
| Pro forma net income per share - diluted | \$ 0.13 | \$ (0.30) | \$ 0.25 | \$ (0.14) |

In the unaudited pro forma results, amortization of liquidity discounts on loans collateralizing asset-backed securities issued and on asset-backed securities issued (which were recognized at the acquisition date) has been recorded into pro forma revenues from January 1, 2008. In addition the gain on bargain purchase upon the acquisition was reflected as if it occurred in the first quarter of 2008 pro forma revenues.

5. Marketable Securities and Other Investments*Other Investments at Fair Value*

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. In determining fair value, the Company uses various methods including market, income and cost approaches. Based on these approaches, the Company often utilizes certain assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and or the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable firm inputs. The Company utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the observability of the inputs used in the valuation techniques, the Company is required to provide the following information according to the fair value hierarchy. The fair value hierarchy ranks the quality and reliability of the information used to determine fair values. Financial instrument assets and liabilities carried at fair value have been classified and disclosed in one of the following three categories:

- Level 1 Quoted market prices in active markets for identical assets or liabilities.
- Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data.
- Level 3 Unobservable inputs that are not corroborated by market data.

Level 1 primarily consists of financial instruments whose value is based on quoted market prices such as U.S. listed and OTC equity securities, as well as quasi-government agency securities, all of which are carried at fair value.

Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including discounted anticipated cash flows, the cost, terms and liquidity of the instrument, the financial condition, operating results and credit ratings of the issuer or underlying company, the quoted market price of publicly traded securities with similar duration and yield, time value, yield curve, prepayment speeds, default rates, loss severity, as well as other measurements. Substantially all of these assumptions are observable in the marketplace, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Included in this category is the general partner investment in hedge funds, where the underlying hedge funds are mainly invested in publicly traded stocks whose value is based on quoted market prices.

Level 3 is comprised of financial instruments whose fair value is estimated based on internally developed models or methodologies utilizing significant inputs that are generally less readily observable from objective sources. A description of the valuation techniques utilized for the fair value of the financial instruments in this category is as follows:

General partner investment in funds of funds and limited partner investment in mortgage and private equity fund: determined by net asset value provided by third party general partners;

Edgar Filing: JMP Group Inc. - Form 10-Q

Investment in NYMT convertible preferred stock: determined by the Company using the Black-Scholes credit adjusted valuation model on Bloomberg;

Warrants: determined by the Company using the Black-Scholes Options Valuation model, and

Equity securities: LSC investment in private companies, determined by the Company using comparable public company metrics discounted for private company market illiquidity.

At each reporting period, all assets and liabilities for which the fair value measurement is based on significant unobservable inputs are classified as Level 3.

Table of Contents

The following tables provide fair value information related to the Company's financial assets and liabilities at September 30, 2009 and December 31, 2008:

| | Assets at Fair Value as of September 30, 2009 | | | Total |
|--|--|---------------|---------------|---------------|
| | Level 1 | Level 2 | Level 3 | |
| Financial instruments owned, at fair value: | | | | |
| Marketable securities owned: | | | | |
| Equity securities | \$ 18,282,610 | \$ | \$ | \$ 18,282,610 |
| Total marketable securities owned | \$ 18,282,610 | \$ | \$ | \$ 18,282,610 |
| Other investments: | | | | |
| General partner investment in hedge funds | \$ | \$ 31,508,978 | \$ | \$ 31,508,978 |
| General partner investment in funds of funds | | | 3,909,035 | 3,909,035 |
| Total general partner investment in funds | | 31,508,978 | 3,909,035 | 35,418,013 |
| Limited partner investment in private equity fund | | | 2,396,179 | 2,396,179 |
| Limited partner investment in mortgage fund | | | 1,633,374 | 1,633,374 |
| Investment in NYMT convertible preferred stock | | | 14,746,199 | 14,746,199 |
| Warrants | | | 74,675 | 74,675 |
| Equity securities | | | 2,434,953 | 2,434,953 |
| Total other investments | \$ | \$ 31,508,978 | \$ 25,194,415 | \$ 56,703,393 |

| | Assets at Fair Value as of December 31, 2008 | | | Total |
|--|---|---------------|---------------|---------------|
| | Level 1 | Level 2 | Level 3 | |
| Financial instruments owned, at fair value: | | | | |
| Marketable securities owned: | | | | |
| Equity securities | \$ 11,976,235 | \$ | \$ | \$ 11,976,235 |
| Quasi-government agency securities | 7,862,245 | | | 7,862,245 |
| Total marketable securities owned | \$ 19,838,480 | \$ | \$ | \$ 19,838,480 |
| Other investments: | | | | |
| General partner investment in hedge funds | \$ | \$ 29,766,076 | \$ | \$ 29,766,076 |
| General partner investment in funds of funds | | | 3,678,073 | 3,678,073 |
| Total general partner investment in funds | | 29,766,076 | 3,678,073 | 33,444,149 |
| Limited partner investment in private equity fund | | | 2,516,115 | 2,516,115 |
| Investment in NYMT convertible preferred stock | | | 11,686,650 | 11,686,650 |
| Warrants | | | 307,341 | 307,341 |
| Total other investments | \$ | \$ 29,766,076 | \$ 18,188,179 | \$ 47,954,255 |

| | Liabilities at Fair Value as of September 30, 2009 | | | Total |
|--|---|---------|---------|--------------|
| | Level 1 | Level 2 | Level 3 | |
| Financial instruments sold, but not yet purchased, at fair value: | | | | |
| Marketable securities sold, but not yet purchased | \$ 9,752,001 | \$ | \$ | \$ 9,752,001 |

Edgar Filing: JMP Group Inc. - Form 10-Q

| | Liabilities at Fair Value as of December 31, 2008 | | | Total |
|--|--|---------|---------|--------------|
| | Level 1 | Level 2 | Level 3 | |
| Financial instruments sold, but not yet purchased, at fair value: | | | | |
| Marketable securities sold, but not yet purchased | \$ 5,677,683 | \$ | \$ | \$ 5,677,683 |

Table of Contents

The following tables provide a reconciliation of the beginning and ending balances for the assets at fair value using significant unobservable inputs (Level 3) for the three months ended September 30, 2009 and 2008:

| | Balance as of June 30, 2009 | Purchases/(sales), net | Total gains and (losses) (realized and unrealized) | Transfers in/(out) of Level 3 | Balance as of September 30, 2009 | Changes in unrealized gains and (losses) included in earnings related to assets still held at reporting date |
|---|--------------------------------|---------------------------|---|----------------------------------|-------------------------------------|--|
| General partner investment in funds of funds | \$ 3,786,876 | \$ | \$ 122,159 | \$ | \$ 3,909,035 | \$ 122,159 |
| Limited partner investment in private equity fund | 2,391,193 | | 4,986 | | 2,396,179 | 4,986 |
| Limited partner investment in mortgage fund | | (393,679) | 27,053 | 2,000,000(2) | 1,633,374 | 27,053 |
| Investment in NYMT convertible preferred stock | 13,867,950 | | 878,249 | | 14,746,199 | 878,249 |
| Warrants | 244,077 | 73,506 | (242,908) | | 74,675 | (242,908) |
| Equity securities | | 2,434,953(1) | | | 2,434,953 | |
| Total Level 3 assets | \$ 20,290,096 | \$ 2,114,780 | \$ 789,539 | \$ 2,000,000 | \$ 25,194,415 | \$ 789,539 |

- (1) On July 31, 2009, the Company received 100% of the membership interest in LSC III, LLC (LSC) in full satisfaction of a \$2.4 million non-revolving credit note. LSC is an investment partnership and owns shares of common and preferred stock of two privately-held companies which had an aggregate fair value of \$2.4 million at July 31, 2009. The Company is the sole member of LSC and therefore has a controlling financial interest in LSC. As a result, the Company consolidates LSC in its consolidated financial statements effective July 31, 2009. The two investments owned by LSC were recorded at fair value as of July 31, 2009 and are included in the Company's Level 3 assets as of September 30, 2009.
- (2) The Company's limited partner investment in a mortgage fund was transferred from Level 2 to Level 3 within the fair value hierarchy due to reduced observability of the inputs used to value the fund's underlying investments.

| | Balance as of June 30, 2008 | Purchases/(sales), net | Total gains and (losses) (realized and unrealized) | Transfers in/(out) of Level 3 | Balance as of September 30, 2008 | Changes in unrealized gains and (losses) included in earnings related to assets still held at reporting date |
|---|--------------------------------|---------------------------|---|----------------------------------|-------------------------------------|---|
| General partner investment in funds of funds | \$ 4,543,753 | \$ | \$ (6,397) | \$ | \$ 4,537,356 | \$ (6,397) |
| Limited partner investment in private equity fund | 2,462,756 | 50,600 | (17,768) | | 2,495,588 | (17,768) |
| Investment in NYMT convertible preferred stock | 14,065,201 | | (1,356,526) | | 12,708,675 | (1,356,526) |
| Warrants | 303,764 | | (2,745) | | 301,019 | (2,745) |
| Total Level 3 assets | \$ 21,375,474 | \$ 50,600 | \$ (1,383,436) | \$ | \$ 20,042,638 | \$ (1,383,436) |

Edgar Filing: JMP Group Inc. - Form 10-Q

The following tables provide a reconciliation of the beginning and ending balances for the assets at fair value using significant unobservable inputs (Level 3) for the nine months ended September 30, 2009 and 2008:

| | Balance as of December 31, 2008 | Purchases/(sales), net | Total gains and (losses) (realized and unrealized) | Transfers in/(out) of Level 3 | Balance as of September 30, 2009 | Changes in unrealized gains and (losses) included in earnings related to assets still held at reporting date |
|---|------------------------------------|---------------------------|--|----------------------------------|-------------------------------------|--|
| General partner investment in funds of funds | \$ 3,678,073 | \$ | \$ 230,962 | \$ | \$ 3,909,035 | \$ 230,962 |
| Limited partner investment in private equity fund | 2,516,115 | (71,600) | (48,336) | | 2,396,179 | (48,336) |
| Limited partner investment in mortgage fund | | (393,679) | 27,053 | 2,000,000(3) | 1,633,374 | 27,053 |
| Investment in NYMT convertible preferred stock | 11,686,650 | 655,600(1) | 2,403,949 | | 14,746,199 | 2,403,949 |
| Warrants | 307,341 | 73,506 | (306,172) | | 74,675 | (306,172) |
| Equity securities | | 2,434,953(2) | | | 2,434,953 | |
| Total Level 3 assets | \$ 18,188,179 | \$ 2,698,780 | \$ 2,307,456 | \$ 2,000,000 | \$ 25,194,415 | \$ 2,307,456 |

- (1) Investment in NYMT convertible preferred stock held by JMPRT at December 31, 2008 of \$7.8 million was removed from the Company's assets in connection with the transfer of JMPRT assets and liabilities to HMOP effective January 2, 2009. The Company did not consolidate HMOP in its consolidated financial statements through April 30, 2009. Effective May 1, 2009, the Company consolidates HMOP in its consolidated financial statements. As a result, the investment in NYMT convertible preferred stock held by HMOP was added to the Company's assets at the fair value as of May 1, 2009 of \$8.5 million and is included in the Company's Level 3 assets as of September 30, 2009.
- (2) On July 31, 2009, the Company received 100% of the membership interest in LSC III, LLC ("LSC") in full satisfaction of a \$2.4 million non-revolving credit note. LSC is an investment partnership and owns shares of common and preferred stock of two privately-held companies which had an aggregate fair value of \$2.4 million at July 31, 2009. The Company is the sole member of LSC and therefore has a controlling financial interest in LSC. As a result, the Company consolidates LSC in its consolidated financial statements effective July 31, 2009. The two investments owned by LSC were recorded at fair value as of July 31, 2009 and are included in the Company's Level 3 assets as of September 30, 2009.
- (3) In the quarter ended September 30, 2009, the Company's limited partner investment in a mortgage fund was transferred from Level 2 to Level 3 within the fair value hierarchy due to reduced observability of the inputs used to value the fund's underlying investments.

Table of Contents

| | Balance as of December 31, 2007 | Purchases/(sales), net | Total gains and (losses) (realized and unrealized) | Transfers in/(out) of Level 3 | Balance as of September 30, 2008 | Changes in unrealized gains and (losses) included in earnings related to assets still held at reporting date |
|--|------------------------------------|---------------------------|---|----------------------------------|-------------------------------------|---|
| General partner investment in funds of funds | \$ 4,460,971 | \$ | \$ 76,385 | \$ | \$ 4,537,356 | \$ 76,385 |
| Limited partner investment in private equity fund | 2,282,582 | 205,600 | 7,406 | | 2,495,588 | 7,406 |
| Investment in NYMT convertible preferred stock | | 15,000,000 | (2,291,325) | | 12,708,675 | (2,291,325) |
| Warrants | 300,503 | | 516 | | 301,019 | 516 |
| Total Level 3 assets | \$ 7,044,056 | \$ 15,205,600 | \$ (2,207,018) | \$ | \$ 20,042,638 | \$ (2,207,018) |

Total gains and losses represent the total gains and/or losses (realized and unrealized) recorded for the Level 3 assets and are reported in Principal Transactions in the accompanying Consolidated Statements of Operations.

Purchases/sales represent the net amount of Level 3 assets that were either purchased or sold during the period. The amounts were recorded at fair value at the date of the transaction.

Net transfers in/out of Level 3 represent existing financial assets that were previously categorized at a different level. Transfers into or out of Level 3 result from changes in the observability of fair value inputs used in determining fair values for different types of financial assets. There were no transfers in/out of Level 3 for the three and nine months ended September 30, 2008.

The amount of unrealized gains and losses included in earnings attributable to the change in unrealized gains and losses relating to Level 3 assets still held at the end of the period were reported in Principal Transactions in the accompanying Consolidated Statements of Operations. The change in unrealized gains and losses are partially offset by realized gains and losses during the period.

Other Investments not at Fair Value

On February 13, 2009 the Company entered into a business arrangement with China Merchants Securities Co.(HK), Ltd., a securities brokerage and investment banking firm, through a \$2.0 million investment in HuaMei Capital Company, Inc. (HuaMei) to expand the Company's investment banking capabilities in China. Through HuaMei, the Company intends to provide investment banking services to U.S. and Chinese companies seeking to execute cross-border transactions on both sides of the Pacific. HuaMei is a joint venture of China Merchants Securities; MVC Capital, Inc., a publicly traded business development company managed by The Tokarz Group Advisers LLC; and the HuaMei Capital founders. HuaMei has co-chief executive officers from China Merchant Securities Co. (HK), Ltd. and the Company. The Company has appointed its chairman and chief executive officer, Joseph Jolson, to serve on HuaMei's board of directors. The Company accounts for its investment in HuaMei under the equity method of accounting within other investments on the Consolidated Statements of Financial Condition. The carrying value of our investment in HuaMei was \$2.0 million at September 30, 2009.

6. Loans Held for Investment

Loans held for investment at September 30, 2009 is comprised of principal investments in the form of two loan notes and advances on one non-revolving credit note commitment. At December 31, 2008, loans held for investments was comprised of principal investments in the form of two loan notes and advances on two non-revolving credit note commitments.

Loan notes include a participation interest in a loan made by JMPRT to a client during 2007. The loan is collateralized by real estate related assets, and bears interest at the rate of 20% per annum, payable monthly in arrears. The principal of the loan was due and payable on December 1, 2007, but was extended until September 2008 for an additional fee at the borrower's option and in connection with a partial repayment. At September 30, 2008, the loan balance of \$855,763 was in default and we had recorded a loan loss provision of \$427,882 in the third quarter of 2008 with no additional reserves recorded since that date. Recovery of the loan is being sought through bankruptcy court proceedings from which the Company believes it will be able to recover at the net realizable value of the loan.

Edgar Filing: JMP Group Inc. - Form 10-Q

In addition, in the third quarter of 2008, the Company made a \$4.2 million loan to a private commercial mortgage originator in the form of a note and warrants. At September 30, 2009 and December 31, 2008 the loan was recorded net of loan loss reserves of \$3.8 million and \$2.4 million respectively.

The Company had also advanced as of December 31, 2008 an aggregate of \$3.8 million on two non-revolving credit note commitments with an original aggregate amount of \$7.0 million. In July 2009, one of the two non-revolving credit notes matured. As of the maturity date, the net carrying value of the credit was \$2.4 million. As permitted by the terms of the credit agreement, at maturity, the borrower conveyed collateral to the Company in full satisfaction of the credit note. The collateral received was the membership interest in LSC III, LLC (see Note 5). As of September 30, 2009, the Company had a \$1.3 million advance on a \$2.0 million original commitment.

Table of Contents

The loan notes and non-revolving credit note commitments bear interest at rates from 15% to 20% per annum with maturity dates ranging from current to four years. At September 30, 2009 and December 31, 2008, \$4.8 million and \$3.4 million of the aggregate amount of loans held for investment were on non-accrual status, respectively.

The following table presents components of loans held for investment, net on the Consolidated Statements of Financial Condition at September 30, 2009 and December 31, 2008:

| | September 30, 2009 | December 31, 2008 |
|--------------------------------------|--------------------|-------------------|
| Loans held for investment | \$ 6,057,418 | \$ 8,812,533 |
| Allowance for loan losses | (4,185,365) | (2,896,149) |
| Deferred loan fees | (180,017) | (190,517) |
| Total loans held for investment, net | \$ 1,692,036 | \$ 5,725,867 |

A summary of the activity in the allowance for loan losses for the three and nine months ended September 30, 2009 and 2008 was as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--------------------------------------|----------------------------------|--------------|---------------------------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| Balance at beginning of period | \$ (4,340,365) | \$ | \$ (2,896,149) | \$ |
| Provision for loan losses | 105,000 | (427,882) | (1,339,216) | (427,882) |
| Loans charged off, net of recoveries | 50,000 | | 50,000 | |
| Balance at end of period | \$ (4,185,365) | \$ (427,882) | \$ (4,185,365) | \$ (427,882) |

The Company determined the fair value of loans held for investment to be \$3.5 million and \$6.0 million as of September 30, 2009 and December 31, 2008 respectively, using anticipated cash flows, discounted at an appropriate market credit adjusted interest rate.

7. Loans Collateralizing Asset-backed Securities Issued

Loans collateralizing asset-backed securities issued are commercial loans securitized and owned by the Cratos CLO. The loans consist of those loans within the CLO securitization structure at the acquisition date of Cratos and loans purchased or originated into the CLO subsequent to the Cratos acquisition date. The following table presents the components of loans collateralizing asset-backed securities issued, net at September 30, 2009:

| | September 30, 2009 |
|--|--------------------|
| Loans collateralizing asset-backed securities | \$ 470,321,664 |
| Allowance for loan losses | (3,026,626) |
| Liquidity discount | (101,270,259) |
| Credit discount | (44,635,334) |
| Deferred loan fees, net | (4,150,533) |
| Total loans collateralizing asset-backed securities, net | \$ 317,238,912 |

JMP Credit provides loans to companies throughout the United States. Although JMP Credit has a diversified loan portfolio, should events occur, including adverse economic conditions, the ability of borrowers to make timely scheduled principal and interest payments on their loans may be adversely affected.

A loan is considered to be impaired when, based on current information, it is probable that the Company will be unable to collect all amounts due in accordance with the contractual terms of the original loan agreement, including scheduled principal and interest payments. There were

Edgar Filing: JMP Group Inc. - Form 10-Q

\$93.5 million of impaired loans as of September 30, 2009, with allocated specific reserves of \$2.8 million and credit discount of \$44.6 million as of September 30, 2009. In addition, in accordance with the authoritative guidance under GAAP on loss contingencies, we collectively evaluate pools of homogeneous loans based on portfolio classification and risk assessment to determine the inherent loss in these portfolios. Based on such evaluation, we recorded pooled reserves of \$0.1 million during the quarter ended September 30, 2009 on loans purchased into the CLO subsequent to the Cratos acquisition.

Table of Contents

A summary of the activity in the allowance for loan losses for the three and nine months ended September 30, 2009 is as follows:

| | Three Months Ended September 30, 2009 | Nine Months Ended September 30, 2009 |
|---|---|--|
| Balance at beginning of period | \$ (2,537,976) | \$ |
| Provision for loan losses: | | |
| Specific reserve | (1,387,864) | (3,806,504) |
| Pooled reserve | (100,786) | (220,122) |
| Reversal due to sale or payoff of loans | 1,000,000 | 1,000,000 |
| Balance at end of period | \$ (3,026,626) | \$ (3,026,626) |

Loans recorded upon the acquisition of Cratos at fair value reflect a liquidity discount and a credit discount. In addition, most loans purchased subsequent to the acquisition were purchased at discount to their principal value, reflecting deferred loan fees. The tables below summarize the activity in the loan principal, liquidity discount, credit discount and deferred fees for the impaired loans at acquisition date and non-impaired loans at acquisition date for the three and nine months ended September 30, 2009:

Impaired loans at acquisition:

| | Three Months Ended September 30, 2009 | | | | Carrying Value, Net |
|--------------------------------|---------------------------------------|------------------------------|--------------------|-----------------|------------------------|
| | Principal | Allowance for Loan Losses | Liquidity Discount | Credit Discount | |
| Balance at beginning of period | \$ 84,340,600 | \$ (2,418,640) | \$ (17,148,785) | \$ (45,724,267) | \$ 19,048,908 |
| Repayments | (2,200,515) | | | 88,933 | (2,111,582) |
| Amortization of discount | | | 985,433 | | 985,433 |
| Provision for loan losses | | (493,750) | | | (493,750) |
| Sales and payoff | (2,357,025) | 1,000,000 | 178,496 | 1,000,000 | (178,529) |
| Balance at end of period | \$ 79,783,060 | \$ (1,912,390) | \$ (15,984,856) | \$ (44,635,334) | \$ 17,250,480 |

Non-impaired loans at acquisition:

| | Three Months Ended September 30, 2009 | | | | Carrying Value, Net |
|--------------------------------|---------------------------------------|------------------------------|--------------------|--------------------|------------------------|
| | Principal | Allowance for Loan Losses | Liquidity Discount | Deferred Loan Fees | |
| Balance at beginning of period | \$ 390,188,797 | \$ (119,336) | \$ (98,726,651) | \$ (2,286,845) | \$ 289,055,965 |
| Purchases / funding | 47,923,401 | | | (2,414,810) | 45,508,591 |
| Repayments | (19,191,387) | | | | (19,191,387) |
| Amortization of discount | | | 6,006,842 | 304,789 | 6,311,631 |
| Provision for loan losses | | (994,900) | | | (994,900) |
| Sales and payoff | (28,382,208) | | 7,434,406 | 246,333 | (20,701,469) |
| Balance at end of period | \$ 390,538,603 | \$ (1,114,236) | \$ (85,285,403) | \$ (4,150,533) | \$ 299,988,431 |

Impaired loans at acquisition:

Edgar Filing: JMP Group Inc. - Form 10-Q

Nine Months Ended September 30, 2009

| | Principal | Allowance for Loan Losses | Liquidity Discount | Credit Discount | Carrying Value, Net |
|--------------------------------|---------------|---------------------------|--------------------|-----------------|---------------------|
| | \$ | \$ | \$ | \$ | \$ |
| Balance at beginning of period | | | | | |
| Cratos acquisitions | 96,466,473 | | (18,599,270) | (51,492,789) | 26,374,414 |
| Repayments | (3,886,633) | | | 88,933 | (3,797,700) |
| Amortization of discount | | | 1,945,918 | | 1,945,918 |
| Provision for loan losses | | (2,912,390) | | | (2,912,390) |
| Sales and payoff | (12,796,780) | 1,000,000 | 668,496 | 6,768,522 | (4,359,762) |
| Balance at end of period | \$ 79,783,060 | \$ (1,912,390) | \$ (15,984,856) | \$ (44,635,334) | \$ 17,250,480 |

Table of Contents**Non-impaired loans at acquisition:**

| | Nine Months Ended September 30, 2009 | | | | Carrying Value, Net |
|--------------------------------|--------------------------------------|------------------------------|--------------------|--------------------|------------------------|
| | Principal | Allowance for Loan Losses | Liquidity Discount | Deferred Loan Fees | |
| Balance at beginning of period | \$ | \$ | \$ | \$ | \$ |
| Cratos acquisitions | 363,701,586 | | (109,576,369) | | 254,125,217 |
| Purchases / funding | 98,439,506 | | | (4,880,734) | 93,558,772 |
| Repayments | (28,238,495) | | | | (28,238,495) |
| Amortization of discount | | | 11,462,992 | 483,868 | 11,946,860 |
| Provision for loan losses | | (1,114,236) | | | (1,114,236) |
| Sales and payoff | (43,363,994) | | 12,827,974 | 246,333 | (30,289,687) |
| Balance at end of period | \$ 390,538,603 | \$ (1,114,236) | \$ (85,285,403) | \$ (4,150,533) | \$ 299,988,431 |

The Company determined the fair value of loans collateralizing asset-backed securities to be \$367.5 million as of September 30, 2009, using anticipated cash flows, discounted at an appropriate market credit adjusted interest rate.

At September 30, 2009, \$93.5 million of the aggregate principal amount of loans collateralizing asset-backed securities were on non-accrual status.

8. Fixed Assets

At September 30, 2009 and December 31, 2008, fixed assets consisted of the following:

| | September 30, 2009 | December 31, 2008 |
|--------------------------------|--------------------|-------------------|
| Furniture and fixtures | \$ 1,560,843 | \$ 1,363,429 |
| Computer and office equipment | 3,599,148 | 3,247,255 |
| Leasehold improvements | 2,374,283 | 2,320,339 |
| Software | 520,157 | 490,194 |
| Less: accumulated depreciation | (6,806,625) | (6,214,203) |
| Total fixed assets, net | \$ 1,247,806 | \$ 1,207,014 |

Depreciation expense for the three months ended September 30, 2009 and 2008 was \$188,789 and \$239,909, respectively. Depreciation expense for the nine months ended September 30, 2009 and 2008 was \$592,422 and \$760,797, respectively.

9. Note Payable

Note payable consists of the revolving and term loans related to the Company's credit facility with City National Bank (the Lender) entered into on August 3, 2006. The Company had a revolving loan of \$2.1 million and a term loan of \$7.8 million outstanding at September 30, 2009 and a term loan of \$8.7 million outstanding at December 31, 2008.

On December 31, 2008, the Company entered into Amendment Number Three to Credit Agreement (the Third Amendment), which amends certain provisions of the Credit Agreement, dated as of August 3, 2006, by and between the Company and the Lender, as amended by Amendment Number One to Credit Agreement, dated as of December 17, 2007 and as further amended by Amendment Number Two to Credit Agreement, dated as of March 27, 2008 (collectively, the Credit Agreement).

The Third Amendment converted the Company's outstanding revolving loans of \$8.7 million into a single term loan as of December 31, 2008. The term loan will be repaid in equal quarterly payments of \$434,043 which commenced on September 30, 2009 and continues through December 31, 2013 and bears interest at the prime rate or LIBOR plus 2.25%. The Third Amendment also provided that of the original \$30.0

Edgar Filing: JMP Group Inc. - Form 10-Q

million revolving line of credit, \$21.0 million remains available under the revolving portion of the Credit Agreement and the annual interest rate provisions of the Credit Agreement are increased from the prime rate minus 1.25% to the prime rate and from LIBOR plus 1.25% to LIBOR plus 2.25%. The Lender will continue to provide revolving loans of up to \$21.0 million through December 31, 2010, on which date the then existing revolving loans will convert into term loans.

During the nine months ended September 30, 2009, the Company drew down \$2.1 million on the revolving line of credit to fund the HuaMei investment and \$4.0 million to fund the purchase of Cratos. The \$4.0 million drawn down to fund the purchase of Cratos was repaid during the same period. In addition, the Company made a scheduled repayment of \$0.9 million on the term loan. The Company had undrawn amounts of \$18.9 million and \$21.0 million under the revolving line of credit with the Lender at September 30, 2009 and December 31, 2008, respectively. Each draw bears interest at the prime rate or LIBOR plus 2.25%.

Table of Contents

The following table shows the repayment schedules for the principal portion of the term loan at September 30, 2009:

| | |
|------------|---------------------|
| 2009 | \$ 868,085 |
| 2010 | 1,736,170 |
| 2011 | 1,736,170 |
| 2012 | 1,736,170 |
| 2013 | 1,736,170 |
| Thereafter | |
| | \$ 7,812,765 |

The Credit Agreement contains financial and other covenants, including, but not limited to, limitations on debt, liens and investments, as well as the maintenance of certain financial covenants. A violation of any one of these covenants could result in a default under the facility, which would permit the bank to terminate our note and require the immediate repayment of any outstanding principal and interest. The Third Amendment modified the financial covenants in the Credit Agreement to remove both the minimum requirement of Net Income (as defined in the Credit Agreement) and the minimum requirement of EBITDA (as defined in the Credit Agreement). The Third Amendment also removed the Fixed Charge Coverage Ratio (as defined in the Credit Agreement) and added a new financial covenant regarding the Company's liquidity. At September 30, 2009, the Company was in compliance with the loan covenants.

In connection with the Third Amendment, the Company paid to the Lender an amendment fee of \$74,202. The term loan is collateralized by a pledge of the Company's assets, including its interests in each of JMP Securities and HCS.

10. Contingent Consideration Payable

As part of the acquisition of Cratos, JMP Credit issued a \$3.0 million zero-coupon note to one of the previous owners of Cratos. The note is payable only from the first \$3.0 million of cash flows derived from the subordinated notes held by JMP Credit. The note was recorded at its fair value of \$2.3 million as of the acquisition date with the difference from the face value of \$0.7 million recorded as a liquidity discount on the acquisition date. The liquidity discount is amortized into interest expense over the expected life of the note which is the sole component of interest expense related to the zero-coupon note. During the nine months ended September 30, 2009, the Company made principal repayments of \$98,792 on the note and recorded interest expense of \$106,878.

11. Asset-backed Securities Issued

On May 17, 2007, Cratos CLO I Ltd. completed a \$500.0 million aggregate principal amount of notes (the Notes) on-balance sheet debt securitization and obtained \$455.0 million of third-party financing. The Notes will be repaid from the cash flows generated by the loan portfolio owned by Cratos CLO I Ltd. The Notes were issued in seven separate classes as set forth in the table below. The Company owns all of the unsecured subordinated notes and \$13.8 million of Class C, D and E notes. These unsecured subordinated notes and the Class C, D and E notes owned by the Company are eliminated upon consolidation of JMP Credit, and therefore, are not reflected on the Company's consolidated statement of financial condition at September 30, 2009.

| Notes | Outstanding Principal Balance | | Liquidity Discount | Net Outstanding Balance | Interest Rate | Ratings |
|--|-------------------------------|--------------------|--------------------|-------------------------|-----------------|--------------------|
| | Originally Issued | September 30, 2009 | September 30, 2009 | September 30, 2009 | Spread to LIBOR | (Moody's/ S&P) (1) |
| Class A Senior Secured Floating Rate Revolving Notes due 2021 | \$ 326.0 | \$ 322.3 | \$ (40.8) | \$ 281.5 | 0.26% - 0.29% | Aaa/AAA |
| Class B Senior Secured Floating Rate Notes due 2021 | 30.0 | 30.0 | (10.2) | 19.8 | 0.50% | Aa2/AA |
| Class C Senior Secured Deferrable Floating Rate Notes due 2021 | 35.0 | 35.0 | (24.2) | 10.8 | 1.10% | Baa3/A |
| | 34.0 | 34.0 | (23.8) | 10.2 | 2.40% | Ba3/BBB |

Edgar Filing: JMP Group Inc. - Form 10-Q

| | | | | | | |
|---|----------|----------|------------|----------|-------|-------|
| Class D Secured Deferrable Floating Rate Notes due 2021 | | | | | | |
| Class E Secured Deferrable Floating Rate Notes due 2021 | 30.0 | 30.0 | (22.8) | 7.2 | 5.00% | B3/BB |
| Total secured notes sold to investors | \$ 455.0 | \$ 451.3 | \$ (121.8) | \$ 329.5 | | |
| Unsecured subordinated notes due 2021 | 45.0 | 45.0 | (39.9) | 5.1 | | |
| Total notes for the CLO I offering | \$ 500.0 | \$ 496.3 | \$ (161.7) | \$ 334.6 | | |
| Consolidation elimination | N/A | (58.7) | 46.9 | (11.8) | | |
| Total asset-backed securities issued | N/A | \$ 437.6 | \$ (114.8) | \$ 322.8 | | |

(1) These ratings are unaudited and were the current ratings as of September 30, 2009 and are subject to change from time to time. The secured notes and subordinated notes are limited recourse obligations payable solely from cash flows of the CLO I loan portfolio and related collection and payment accounts pledged as security. Payment on the Class A-1 notes rank equal, or pari passu, in right of payment with payments on the Class A-2 notes and payment on the Class A-1 and Class A-2 notes rank senior in right of payment to the other secured notes and the subordinated notes. Payment on the Class B, Class C, Class D and Class E notes generally rank subordinate in right of payment to any other class of notes which has an earlier alphabetical designation. The subordinated notes are subordinated in right of payment to all other classes of notes and will not accrue interest. Interest on the secured notes is payable quarterly at a per annum rate equal to LIBOR plus the applicable spread set forth in the table above. Payment of interest on the Class C, Class D and Class E notes is payable only to the extent proceeds are available therefore under the applicable payment priority provisions. As of September 30, 2009, all interest on the secured notes was paid. To the extent proceeds are not so available, interest on the Class C, Class D and Class E notes will be deferred. Cratos CLO I, Ltd. is also required to pay a commitment fee of 0.18% on the unused portion of the funding commitments of the Class A-1 notes. The secured notes are secured by the CLO I loan portfolio and the funds on deposit in various related collection and payment accounts. The terms of the debt securitization subject the loans included in the CLO I loan portfolio to a number of collateral quality, portfolio profile, interest coverage and overcollateralization tests. Total interest expense related to the asset-backed securities issued for the three months ended September 30, 2009 was \$8.3 million, which comprised cash coupon of \$1.5 million and liquidity discount amortization of \$6.8 million. Total interest expense for the nine months ended September 30, 2009 was \$17.1 million, which comprised cash coupon of \$3.4 million and liquidity discount amortization of \$13.7 million. As of September 30, 2009, accrued interest payable on the Notes was \$0.6 million.

Table of Contents

The Notes recorded upon the acquisition of Cratos at fair value reflect a liquidity discount. The activity in the note principal and liquidity discount for the three and nine months ended September 30, 2009 comprised the following:

| | Three Months Ended September 30, 2009 | | |
|--------------------------------|---------------------------------------|--------------------|----------------|
| | Principal | Liquidity Discount | Net |
| Balance at beginning of period | \$ 445,240,000 | \$ (121,014,935) | \$ 324,225,065 |
| Repayments | (3,668,244) | | (3,668,244) |
| Post-acquisition purchases | (4,000,000) | (592,800) | (4,592,800) |
| Sales | | | |
| Amortization of discount | | 6,823,414 | 6,823,414 |
| Balance at end of period | \$ 437,571,756 | \$ (114,784,321) | \$ 322,787,435 |

| | Nine Months Ended September 30, 2009 | | |
|--------------------------------|--------------------------------------|--------------------|----------------|
| | Principal | Liquidity Discount | Net |
| Balance at beginning of period | \$ | \$ | \$ |
| Cratos acquisitions | 440,950,000 | (124,437,000) | 316,513,000 |
| Repayments | (3,668,244) | | (3,668,244) |
| Post-acquisition purchases | (4,760,000) | | (4,760,000) |
| Sales | 5,050,000 | (4,054,000) | 996,000 |
| Amortization of discount | | 13,706,679 | 13,706,679 |
| Balance at end of period | \$ 437,571,756 | \$ (114,784,321) | \$ 322,787,435 |

The Company determined the fair value of asset-backed securities issued to be \$337.8 million as of September 30, 2009.

12. Stockholders Equity*Common Stock*

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

Stock Repurchase Program

A 1.5 million share repurchase program authorized in August and November 2007 was fully executed as of January 18, 2008. On March 10, 2008 and March 3, 2009, the Company's board of directors authorized the repurchase of an additional 2.0 million shares during the subsequent eighteen months and the repurchase of an additional 0.5 million shares during the subsequent twelve months, respectively. During the quarter ended September 30, 2009, the Company repurchased 324 shares of the Company's common stock, all of which were repurchased in connection with employee stock plans whereby the Company's shares were tendered by employees for the payment of applicable withholding taxes, at \$6.40 per share for an aggregate purchase price of \$2,074. The timing and amount of any future repurchases will be determined by JMP management based on its evaluation of market conditions, the relative attractiveness of other capital deployment activities, regulatory considerations and other factors.

13. Stock-Based Compensation

On March 26, 2007, the board of directors adopted the JMP Group Inc. 2007 Equity Incentive Plan (JMP Group 2007 Plan), which was approved by the stockholders on April 12, 2007. JMP Group Inc. authorized the issuance of 4,000,000 shares of its common stock under this

Edgar Filing: JMP Group Inc. - Form 10-Q

Plan. This amount is increased by any shares JMP Group Inc. purchases on the open market, or through any share repurchase or share exchange program, as well as any shares that may be returned to the JMP Group 2007 Plan or the JMP Group LLC 2004 Equity Incentive Plan (JMP Group 2004 Plan) as a result of forfeiture, termination or expiration of awards; not to exceed a maximum aggregate number of shares of 2,960,000 shares under the JMP Group 2004 Plan. The Company will issue shares upon exercises or vesting from authorized but unissued shares or from treasury stock.

Table of Contents

Stock Options

The following table summarizes the stock option activity for the nine months ended September 30, 2009:

| | Nine Months Ended September 30, 2009 | |
|--------------------------------------|---|---------------------------------------|
| | Shares Subject to Option | Weighted Average Exercise Price |
| Balance, beginning of year | 2,086,990 | \$ 11.40 |
| Granted | | |
| Exercised | (8,325) | 10.00 |
| Forfeited | (4,625) | 10.00 |
| Expired | (108,875) | 12.76 |
| Balance, end of period | 1,965,165 | \$ 11.33 |
| Options exercisable at end of period | 1,721,692 | \$ 11.50 |

| Range of Exercise Prices | As of September 30, 2009 | | | | Options Vested and Exercisable | | | |
|--------------------------------|--|---------------------------------------|---------|----|--------------------------------|------|---------|-----------------------|
| | Options Outstanding | | | | | | | |
| | Weighted Average Remaining Contractual Life in Years | Weighted Average Exercise Price | | | | | | Number Exercisable |
| \$10.00 - \$15.00 | 1,965,165 | 5.13 | \$11.33 | \$ | 1,721,692 | 4.99 | \$11.50 | \$ |

The Company recognizes stock-based compensation expense for stock options over the graded vesting period of the options using the accelerated attribution method. The Company recognized compensation expense related to stock options of \$4,002 and \$11,311 for the three months ended September 30, 2009 and 2008, respectively, and \$14,852 and \$28,078 for the nine months ended September 30, 2009 and 2008, respectively.

As of September 30, 2009, there was \$7,301 of unrecognized compensation expense related to stock options expected to be recognized over a weighted average period of 0.28 years.

Restricted Stock Units

The Company has granted restricted stock units (RSUs) to employees and non-employee directors at no cost to the recipient. An RSU entitles the recipient to receive a share of common stock after the applicable restrictions lapse. These awards are generally subject to vesting schedules and continued employment with the Company. Some of these awards are also subject to post vesting lockup restrictions. In the event of a change in control or corporate transactions, or if the vesting of all or certain of the RSUs are otherwise accelerated, the RSUs will vest immediately prior to the effective date of such an event.

On February 5, 2009, as a part of the 2008 annual compensation program, the Company awarded 800,000 RSUs to certain employees. These units will vest on the fourth anniversary of grant date and are not subject to a lockup period. The total fair value of these awards on grant date was \$3,384,000. The fair value per unit of \$4.23 was based on the market value of the underlying stock on grant date, discounted for future dividends not expected to be received by unvested RSUs over the vesting period. On the same date, as a part of the 2008 annual compensation program, the Company granted 87,076 shares of restricted stock to certain employees. These shares vested immediately with a two-year restricted period subject to non-competition, non-solicitation and certain other covenants. The total fair value of this grant was \$435,382 and the fair value per share was based on the closing price of the underlying stock on grant date of \$5.00.

Edgar Filing: JMP Group Inc. - Form 10-Q

On March 3, 2009, the Company awarded 18,000 RSUs to a new independent director. Of these units, 33% vested immediately on grant date, with the remaining balance vesting 33% on each of the two subsequent anniversaries. The fair value of these units was \$4.59 per share and was calculated based on the market value of the underlying stock on grant date, discounted for future dividends expected not to be received by unvested RSUs over the vesting period. On April 17, 2009, the Company awarded 13,200 RSUs to the Company's independent directors. These units will vest 100% in 2010. The fair value of these units was \$4.43 per share and was calculated based on the market value of the underlying stock on grant date, discounted for future dividends expected not to be received by unvested RSUs over the vesting period. There is no lockup period for these units granted to the Company's independent directors.

In addition, the Company awarded 153,248 RSUs to new hire employees during the nine months ended September 30, 2009. These units will vest on the fourth anniversary of grant date and are not subject to a lockup period. The fair value per unit was based on the market value of the underlying stock on grant date, discounted for future dividends not expected to be received by unvested RSUs over the vesting period.

Table of Contents

The following table summarizes the RSU activity for the nine months ended September 30, 2009:

| | Nine Months Ended September 30, 2009 | |
|-------------------------------|---|---|
| | Restricted Stock Units | Weighted Average Grant Date Fair Value |
| Balance, beginning of year | 2,265,292 | \$ 8.94 |
| Granted | 984,448 | 4.77 |
| Vested | (389,585) | 10.18 |
| Forfeited | (125,813) | 9.49 |
| Balance, end of period | 2,734,342 | \$ 7.24 |

The Company recognizes compensation expense over a graded vesting period using the accelerated attribution method. For the three months ended September 30, 2009 and 2008, the Company recorded compensation expense of \$707,595 and \$789,049, respectively, related to RSUs awarded in connection with the initial public offering. For the nine months ended September 30, 2009 and 2008, the Company recorded compensation expense of \$2,468,762 and \$3,027,717, respectively, related to RSUs awarded in connection with the initial public offering. In addition, for the three months ended September 30, 2009 and 2008, the Company recorded compensation expense of \$542,633 and \$1,214,612, respectively, for RSUs granted after the initial public offering. For the nine months ended September 30, 2009 and 2008, the Company recorded compensation expense of \$1,417,513 and \$3,532,635, respectively, related to RSUs granted after the initial public offering.

As of September 30, 2009, there was \$10,789,351 of unrecognized compensation expense related to RSUs expected to be recognized over a weighted average period of 2.33 years.

14. Net Income (Loss) per Share of Common Stock

Basic net income (loss) per share for the Company is calculated by dividing net income (loss) by the weighted average number of common shares outstanding for the reporting period. Diluted net income (loss) per share is calculated by adjusting the weighted average number of outstanding shares to reflect the potential dilutive impact as if all potentially dilutive stock options or RSUs were exercised or converted under the treasury stock method. However, for periods that we have a net loss the effect of outstanding stock options or RSUs is anti-dilutive and, accordingly, is excluded from the calculation of diluted loss per share.

The computations of basic and diluted net income (loss) per share for the three and nine months ended September 30, 2009 and 2008 are shown in the tables below:

| | Three Months Ended September 30, 2009 | | Nine Months Ended September 30, 2008 | |
|--|--|----------------|---|----------------|
| <i>Numerator:</i> | | | | |
| Net income (loss) attributable to JMP Group Inc. | \$ 2,968,776 | \$ (4,898,705) | \$ 7,288,905 | \$ (4,025,435) |
| <i>Denominator:</i> | | | | |
| Basic weighted average shares outstanding | 20,754,502 | 20,035,637 | 20,633,361 | 20,317,627 |
| Effect of potential dilutive securities: | | | | |
| Restricted stock units | 1,260,221 | | 1,006,888 | |
| Diluted weighted average shares outstanding | 22,014,723 | 20,035,637 | 21,640,249 | 20,317,627 |
| Net income per share | | | | |
| Basic | \$ 0.14 | \$ (0.24) | \$ 0.35 | \$ (0.20) |

Edgar Filing: JMP Group Inc. - Form 10-Q

Diluted \$ 0.13 \$ (0.24) \$ 0.34 \$ (0.20)

Stock options to purchase 1,981,661 and 2,029,712 shares of common stock for the three and nine months ended September 30, 2009, respectively, were anti-dilutive and, therefore, were not included in the computation of diluted weighted-average common shares outstanding. Stock options to purchase 2,222,730 and 2,279,322 shares of common stock for the three and nine months ended September 30, 2008, respectively, were anti-dilutive and, therefore, were not included in the computation of diluted weighted-average common shares outstanding. Restricted stock units for zero and 16,811 shares of common stock for the three and nine months ended September 30, 2009, respectively, were anti-dilutive and, therefore, were not included in the computation of diluted weighted-average common shares outstanding. Restricted stock units for 3,341,689 and 3,317,110 shares of common stock for the three and nine months ended September 30, 2008, respectively, were anti-dilutive and, therefore, were not included in the computation of diluted weighted-average common shares outstanding.

15. Employee Benefits

All salaried employees of the Company are eligible to participate in the JMP Group 401(k) Plan after three months of employment. Participants may contribute up to the limits set by the United States Internal Revenue Service. There were no contributions by the Company during the three and nine months ended September 30, 2009 and 2008.

Table of Contents**16. Income Taxes**

Prior to the Reorganization, all income and losses of JMP Group LLC, the Predecessor, were reportable by the individual members of JMP Group LLC in accordance with the Internal Revenue Code of the United States. The U.S. federal and state income taxes payable by the members based upon their share of JMP Group LLC's net income have not been reflected in the accompanying financial statements for periods prior to the Reorganization. JMP Holdings Inc., being a C-corporation from its inception in August 2004, was subject to U.S. federal and state income taxes on its taxable income and accounted for income taxes in its separate financial statements.

As a result of the Reorganization, JMP Group Inc. (formerly JMP Holdings Inc.) succeeded to the business of the Predecessor. The Company is subject to U.S. federal and state income taxes on all taxable income earned subsequent to May 15, 2007 by JMP Group LLC and its subsidiaries. As a result of the Reorganization, upon the change of tax status of JMP Group LLC from a partnership to a wholly-owned disregarded entity of the Company, the Company recognized a one-time tax benefit of \$4,084,993 in connection with the establishment of net deferred tax items of \$10,169,354. For the three and nine months ended September 30, 2009, the Company recorded a total tax expense of \$2,879,018 and \$6,491,386, respectively. For the three and nine months ended September 30, 2008, the Company recorded a total tax benefit of \$2,971,386 and \$2,485,284, respectively, which included a tax expense (benefit) adjustment of \$0 and \$(317,168), respectively, to the \$4,084,993 one-time tax benefit recorded in 2007.

The components of the Company's income tax (benefit) expense for the three and nine months ended September 30, 2009 and 2008 are as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|-----------------------|---------------------------------|-----------------------|
| | 2009 | 2008 | 2009 | 2008 |
| Federal | \$ (542,486) | \$ (63,454) | \$ (210,721) | \$ 3,551,361 |
| State | (122,996) | (17,081) | (10,642) | 884,970 |
| Total current income tax expense (benefit) | (665,482) | (80,535) | (221,363) | 4,436,331 |
| Federal | 2,767,972 | (1,974,865) | 5,264,949 | (5,487,846) |
| State | 776,528 | (915,986) | 1,447,800 | (1,433,769) |
| Total deferred expense (benefit) | 3,544,500 | (2,890,851) | 6,712,749 | (6,921,615) |
| Total expense (benefit) from income taxes | \$ 2,879,018 | \$ (2,971,386) | \$ 6,491,386 | \$ (2,485,284) |

A reconciliation of the statutory U.S. federal income tax rate to the Company's effective tax rate for the three months ended September 30, 2009 and 2008 are as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|----------------------------------|---------------|---------------------------------|---------------|
| | 2009 | 2008 | 2009 | 2008 |
| Tax at federal statutory tax rate | 35.00% | 35.00% | 35.00% | 35.00% |
| State income tax, net of federal tax benefit | 5.75% | 5.75% | 5.75% | 5.75% |
| Adjustment for permanent items | 0.03% | -0.23% | -2.91% | -1.56% |
| Rate before one-time events | 40.78% | 40.52% | 37.84% | 39.19% |
| Deferred tax asset written off related to options and RSUs | 0.14% | -0.43% | 4.62% | -3.06% |
| Adjustment for prior year taxes | 2.54% | -2.35% | -0.53% | -2.83% |
| Deferred tax recognized upon JMP Group LLC's tax status change | | | | 4.87% |
| Post-acquisition adjustment to deferred tax liability of Cratos | 0.43% | | 1.32% | |
| Effective tax rate | 43.89% | 37.74% | 43.25% | 38.17% |

Edgar Filing: JMP Group Inc. - Form 10-Q

The Company has analyzed the filing positions in its federal and state tax returns for all open tax years 2005 through 2008. The Company does not anticipate any tax adjustments that will result in a material adverse effect on the Company's financial condition, results of operations, or cash flow. Therefore, the Company did not record a cumulative effect adjustment related to the adoption of the accounting principles related to uncertainty in income taxes, and no liabilities for uncertain income tax positions have been recorded.

The Company's policy for recording interest and penalties associated with the tax audits or unrecognized tax benefits, if any, is to record such items as a component of income before taxes. Penalties, if incurred, would be recorded in administration and interest paid or received would be recorded in interest and dividend expense in the Consolidated Statements of Operations.

17. Commitments and Contingencies

The Company leases office space in California, Illinois, Georgia, Massachusetts and New York under various operating leases. Rental expense for the three months ended September 30, 2009 and 2008 was \$610,091 and \$478,317, respectively. Rental expense for the nine months ended September 30, 2009 and 2008 was \$1,787,608 and \$1,426,136, respectively.

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

| | |
|------------|---------------------|
| 2009 | \$ 594,709 |
| 2010 | 2,417,106 |
| 2011 | 1,797,104 |
| 2012 | 82,745 |
| 2013 | 54,097 |
| Thereafter | 60,167 |
| | <u>\$ 5,005,928</u> |

Table of Contents

In connection with its underwriting activities, JMP Securities enters into firm commitments for the purchase of securities in return for a fee. These commitments require JMP Securities to purchase securities at a specified price. Securities underwriting exposes JMP Securities to market and credit risk, primarily in the event that, for any reason, securities purchased by JMP Securities cannot be distributed at anticipated price levels. At September 30, 2009, JMP Securities had no open underwriting commitments.

The marketable securities owned and the restricted cash as well as the cash held by the clearing broker, may be used to maintain margin requirements. At September 30, 2009 and December 31, 2008, the Company had \$255,336 of cash on deposit with JMP Securities' clearing broker. Furthermore, the marketable securities owned may be hypothecated or borrowed by the clearing broker.

Unfunded commitments are agreements to lend to a borrower, provided that all conditions have been met. As of September 30, 2009, the Company had unfunded commitments of \$3.6 million in the Corporate Credit segment.

18. Regulatory Requirements

JMP Securities is subject to the SEC's Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital, as defined, and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. JMP Securities had net capital of \$31,709,956 and \$39,761,064, which were \$30,222,956 and \$38,681,564 in excess of the required net capital of \$1,487,000 and \$1,079,500 at September 30, 2009 and December 31, 2008, respectively. JMP Securities' ratio of aggregate indebtedness to net capital was 0.41 to 1 and 0.24 to 1 at September 30, 2009 and December 31, 2008, respectively.

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

19. Related Party Transactions

The Company earns base management fees and incentive fees from serving as investment advisor for various entities, including corporations, partnerships and offshore investment companies. The Company may also own an investment in these companies. Base management fees earned from these activities were \$2,241,330 and \$1,673,380 for the three months ended September 30, 2009 and 2008, respectively. Also, HCS earned incentive fees of \$1,060,298 and \$644,123 from these entities for the three months ended September 30, 2009 and 2008, respectively. Base management fees earned from these activities were \$6,324,896 and \$4,073,669 for the nine months ended September 30, 2009 and 2008, respectively. Also, HCS earned incentive fees of \$9,517,256 and \$2,399,725 from these entities for the nine months ended September 30, 2009 and 2008, respectively.

On April 30, 2009, a portion of Cratos CLO I class C, D and E notes were sold to two officers of Cratos Capital Partners LLC. The par value of these notes was \$5,050,000 which were sold to the officers at the current fair market value of \$996,000. The difference between the par value and the purchase price was recorded as liquidity discount on the Company's consolidated statements of financial condition.

20. Guarantees

JMP Securities has agreed to indemnify its clearing broker for losses that the clearing broker may sustain from the accounts of customers introduced by JMP Securities. Should a customer not fulfill its obligation on a transaction, JMP Securities may be required to buy or sell securities at prevailing market prices in the future on behalf of its customer. JMP Securities' obligation under the indemnification has no maximum amount. All unsettled trades at September 30, 2009 had settled with no resulting material liability to the Company. For the three months ended September 30, 2009 and 2008, the Company had no material loss due to counterparty failure, and has no obligations outstanding under the indemnification arrangement as of September 30, 2009.

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

21. Litigation

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

Table of Contents

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

22. Financial Instruments with Off-Balance Sheet Risk, Credit Risk or Market Risk

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

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

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

In connection with the Cratos CLO, the Company is party to financial instruments with off-balance sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include unfunded commitments to lend and standby letters of credit. The instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the consolidated balance sheet of the Company.

Unfunded commitments are agreements to lend to a borrower, provided that all conditions have been met. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since certain commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each borrower's creditworthiness on a case by case basis.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a borrower to a third party. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to borrowers. As of September 30, 2009, the Company had unfunded commitments of \$3.6 million and standby letters of credit of \$1.7 million in the Corporate Credit segment.

23. Business Segments

For the three and nine months ended September 30, 2008, the Company's business results were categorized into the following two segments: Broker-Dealer and Asset Management. As a result of the acquisition of Cratos in April 2009, the Company's business results are now categorized into the following three business segments: 1) Broker-Dealer, 2) Asset Management and 3) Corporate Credit. The Broker-Dealer segment includes a broad range of services, such as underwriting and acting as a placement agent for public and private capital raising transactions and financial advisory services in M&A, restructuring and other strategic transactions. The Broker-Dealer segment also includes institutional brokerage services and equity research services to our institutional investor clients. The Asset Management segment includes the management of a broad range of pooled investment vehicles, including the Company's hedge funds, funds of funds, JMPRT and HMOP as well as the Company's principal investments in public and private securities. The Corporate Credit segment includes the management of collateralized loan obligations. With the disclosure of this new segment, the results and assets of JMP Capital, which for 2008 financial statements were reported in the Asset Management segment, are now reported in the Corporate Credit segment as they are more closely aligned with those newly acquired operations. For the comparative 2008 periods reported below JMP Capital has therefore been reported separately in the Corporate Credit segment.

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

Edgar Filing: JMP Group Inc. - Form 10-Q

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

The Company's segment information for the three and nine months ended September 30, 2009 and 2008 was prepared using the following methodology:

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

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

Table of Contents

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

The Company evaluates segment results based on revenue and segment operating income before noncontrolling interest and taxes.

Segment Operating Results

Management believes that the following information provides a reasonable representation of each segment's contribution to revenues, income (loss) before noncontrolling interest and income tax expense (benefit) and assets:

| | Three Months Ended September 30, 2009 | | Nine Months Ended September 30, 2009 | |
|---|---------------------------------------|----------------|--------------------------------------|----------------|
| | 2009 | 2008 | 2009 | 2008 |
| Broker-Dealer | | | | |
| Net revenues after provision for loan losses | \$ 22,448,742 | \$ 13,097,217 | \$ 59,043,440 | \$ 48,602,555 |
| Non-interest expenses | 22,681,446 | 19,746,159 | 56,930,480 | 54,634,095 |
| Segment income (loss) before income tax expense | \$ (232,704) | \$ (6,648,942) | \$ 2,112,960 | \$ (6,031,540) |
| Segment assets | \$ 88,661,361 | \$ 85,091,849 | \$ 88,661,361 | \$ 85,091,849 |
| Asset Management | | | | |
| Net revenues after provision for loan losses | \$ 5,258,562 | \$ 1,960,873 | \$ 24,257,399 | \$ 7,494,238 |
| Non-interest expenses | 6,800,112 | 3,580,188 | 23,203,431 | 8,153,603 |
| Segment income (loss) before income tax expense | \$ (1,541,550) | \$ (1,619,315) | \$ 1,053,968 | \$ (659,365) |
| Segment assets | \$ 70,892,352 | \$ 62,742,949 | \$ 70,892,352 | \$ 62,742,949 |
| Corporate Credit | | | | |
| Net revenues after provision for loan losses | \$ 14,011,693 | \$ 238,537 | \$ 20,089,444 | \$ 248,077 |
| Non-interest expenses | 5,677,638 | 209,579 | 8,248,622 | 282,549 |
| Segment income (loss) before income tax expense | \$ 8,334,055 | \$ 28,958 | \$ 11,840,822 | \$ (34,472) |
| Segment assets | \$ 400,459,553 | \$ 8,100,858 | \$ 400,459,553 | \$ 8,100,858 |
| Consolidated Entity | | | | |
| Net revenues after provision for loan losses | \$ 41,718,997 | \$ 15,296,627 | \$ 103,390,283 | \$ 56,344,870 |
| Non-interest expenses | 35,159,196 | 23,535,926 | 88,382,533 | 63,070,247 |
| Income (loss) before income tax expense | \$ 6,559,801 | \$ (8,239,299) | \$ 15,007,750 | \$ (6,725,377) |
| Total assets | \$ 560,013,266 | \$ 155,935,656 | \$ 560,013,266 | \$ 155,935,656 |

24. Summarized financial information for equity method investments and NYMT

The table below presents summarized financial information of the hedge funds and funds of funds which the Company accounts for under the equity method.

| September 30, 2009 | Three Months Ended September 30, 2009 | | Nine Months Ended September 30, 2009 | |
|--------------------|---------------------------------------|-----------------------------------|--------------------------------------|-----------------------------------|
| | Net Investment Income (Loss) | Net Realized and Unrealized Gains | Net Investment Income (Loss) | Net Realized and Unrealized Gains |
| Net Assets | | | | |

Edgar Filing: JMP Group Inc. - Form 10-Q

| Hedge Funds: | | | | | |
|---------------------------------|---------------|--------------|--------------|--------------|---------------|
| Harvest Opportunity Partners II | \$ 69,187,845 | \$ (111,682) | \$ 7,815,898 | \$ (425,304) | \$ 13,751,872 |
| Harvest Small Cap Partners | 318,576,053 | (2,841,101) | (11,762,395) | (12,583,919) | 39,360,364 |
| Harvest Consumer Partners | 12,093,803 | (27,819) | 543,569 | (92,052) | 1,331,693 |
| Harvest Technology Partners | 20,551,527 | (83,844) | (127,123) | (241,339) | 2,808,949 |
| Harvest Global Select Partners | 5,764,392 | (67,760) | 73,451 | (114,996) | 135,713 |
| Funds of Funds: | | | | | |
| JMP Masters Fund | 97,938,057 | (168,977) | 4,270,705 | (551,132) | 10,586,865 |
| JMP Emerging Masters Fund | 11,225,526 | (27,481) | 121,733 | (103,533) | 619,073 |

Table of Contents

The tables below present summarized financial information of NYMT at September 30, 2009 and December 31, 2008 as well as for the three months ended September 30, 2009 and 2008.

| (In thousands) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|----------------------------------|-----------|---------------------------------|-----------|
| | 2009 | 2008 | 2009 | 2008 |
| Statement of Operations Data: | | | | |
| Interest income - investment securities and loans held in securitization trusts | \$ 7,994 | \$ 10,324 | \$ 24,200 | \$ 34,332 |
| Interest expense - investment securities and loans held in securitization trusts | 1,864 | 6,692 | 7,041 | 23,997 |
| Provision for loan losses | (526) | (7) | (1,414) | (1,462) |
| Impairment loss on investment securities | | | (119) | |
| Realized gain (loss) on securities and related hedges | 359 | 4 | 623 | (19,927) |
| Income (loss) from continuing operations | 2,640 | 744 | 6,978 | (20,260) |
| Net income (loss) | 2,876 | 1,029 | 7,478 | (18,966) |

| | September 30, 2009 | December 31, 2008 |
|--|-----------------------|----------------------|
| Statement of Financial Condition Data: | | |
| Investment securities - available for sale | \$ 282,594 | \$ 477,416 |
| Mortgage loans held in securitization trusts (net) | 290,940 | 348,337 |
| Total assets | 608,114 | 853,300 |
| Financing arrangements, portfolio investments | 194,745 | 402,329 |
| Collateralized debt obligations | 280,223 | 335,646 |
| Convertible preferred debentures (net) | 19,814 | 19,702 |
| Total liabilities | 549,965 | 814,052 |

25. Subsequent Events

The Company has performed an evaluation of subsequent events through November 4, 2009, which is the date the financial statements were issued.

On November 2, 2009, the Company's board of directors declared a cash dividend of \$0.01 per share of common stock for the third quarter of 2009 to be paid on December 4, 2009, to common stockholders of record on November 20, 2009.

On November 2, the Company's Board of Directors approved amendments to, and the immediate acceleration of the vesting of approximately 1.3 million RSUs that were granted in the first quarter of 2008 and 2009 to certain employees, including each of the Company's named officers, under the Company's 2007 Equity Incentive Plan. The acceleration was to align the terms of existing RSUs with those of future RSUs, which are expected to have performance-based vesting conditions instead of service-based vesting conditions. These accelerated RSUs remain subject to the terms and conditions of the applicable restricted stock unit agreement, which include lockup provisions and potential forfeiture if the holder breaches certain covenants, including non-competition covenants. In connection with the above vesting, the Company repurchased 526,400 shares of its common stock, mainly to allow employees to tender shares for the payment of the statutory minimum withholding taxes.

Table of Contents

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) should be read together with the unaudited consolidated financial statements and the related notes included elsewhere in this report. For additional context with which to understand our financial condition and results of operations, refer to the MD&A for the fiscal year ended December 31, 2008 contained in our annual report on Form 10-K filed with the SEC on March 9, 2009, as well as the Consolidated Financial Statements and Notes contained therein.

Cautionary Statement Regarding Forward Looking Statements

This MD&A and other sections of this report contain forward looking statements. We make forward-looking statements, as defined by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, and in some cases, you can identify these statements by forward-looking words such as if, shall, may, might, will likely result, should, expect, plan, anticipate, believe, estimate, objective, predict, potential or continue, the negative of these terms and other comparable terminology. These forward-looking statements, which are based on various underlying assumptions and expectations and are subject to risks, uncertainties and other unknown factors, may include projections of our future financial performance based on our growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events that we believe to be reasonable. There are or may be important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the historical or future results, level of activity, performance or achievements expressed or implied by such forward-looking statements. These factors include, but are not limited to, those discussed under the caption Risk Factors in our annual report on Form 10-K. In preparing this MD&A, we presume that readers have access to and have read the MD&A in our Annual report on Form 10-K, pursuant to Instruction 2 to paragraph (b) of Item 303 of Regulation S-K. We undertake no duty to update any of these forward-looking statements after the date of filing of this report to conform such forward-looking statements to actual results or revised expectations, except as otherwise required by law.

Overview

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

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

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

proprietary equity research in our six target industries;

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

management of collateralized loan obligations.

Components of Revenues

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

Investment Banking

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

Edgar Filing: JMP Group Inc. - Form 10-Q

On February 13, 2009, we entered into a business arrangement with China Merchants Securities Co.(HK), Ltd., one of China's largest securities brokerage and investment banking firms, through a \$2.0 million investment in HuaMei Capital Company, Inc. (HuaMei) to expand our investment banking capabilities in China. Through HuaMei, we can provide investment banking services to U.S. and Chinese companies seeking to execute cross-border transactions on both sides of the Pacific. As of September 30, 2009, no revenue has yet been generated from our investment in HuaMei.

Underwriting Revenues

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

Strategic Advisory Revenues

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

Table of Contents

Private Placement Revenues

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

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

Brokerage Revenues

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

Asset Management Fees

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

As of September 30, 2009, the contractual base management fees earned from each of these investment funds ranged between 1% and 2% of assets under management. The contractual incentive fees were generally (i) 20%, subject to high-water marks, for the hedge funds; (ii) 5% to 20%, subject to high-water marks or a performance hurdle rate, for the funds of funds; and (iii) 25%, subject to a performance hurdle rate, for HMOP and NYMT.

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

Table of Contents

The following tables present certain information with respect to the investment funds managed by Harvest Capital Strategies (HCS) (formerly JMP Asset Management LLC, which changed its name to HCS effective September 29, 2008):

| | Net Assets at | | Company's Share of Net Assets at | |
|---|-----------------------|-----------------------|----------------------------------|----------------------|
| | September 30, 2009 | December 31, 2008 | September 30, 2009 | December 31, 2008 |
| Funds Managed by HCS: | | | | |
| Hedge Funds: | | | | |
| Harvest Opportunity Partners II | \$ 69,187,845 | \$ 62,169,209 | \$ 10,056,129 | \$ 7,760,076 |
| Harvest Small Cap Partners | 318,576,053 | 234,051,639 | 8,170,867 | 13,780,667 |
| Harvest Consumer Partners | 12,093,803 | 5,521,880 | 5,278,773 | 2,407,121 |
| Harvest Technology Partners | 20,551,527 | 11,581,561 | 6,982,686 | 5,818,212 |
| Harvest Mortgage Opportunities Partners (1) | 14,098,856 | | 9,479,767 | |
| Harvest Global Select Partners | 5,764,392 | | 1,020,523 | |
| Funds of Funds: | | | | |
| JMP Masters Fund | 97,938,057 | 96,037,447 | 2,891,659 | 2,701,021 |
| JMP Emerging Masters Fund | 11,225,526 | 10,633,335 | 1,017,376 | 977,052 |
| REITs: | | | | |
| JMP Realty Trust (1) | | 15,829,296 | | 7,841,833 |
| New York Mortgage Trust (2) | 48,413,824 | 48,413,824 | N/A | N/A |
| Total funds managed by HCS | \$ 597,849,883 | \$ 484,238,191 | \$ 44,897,780 | \$ 41,285,982 |

- (1) The Company's share of net assets in JMPRT was consolidated in the Company's Statement of Financial Condition at December 31, 2008. On January 2, 2009, all of the assets and liabilities of JMPRT were transferred to HMOP. The Company's share of net assets in HMOP was consolidated in the Company's Statement of Financial Condition at September 30, 2009.
- (2) The portion of the net assets of New York Mortgage Trust, Inc. (NYMT) that is subject to the management fee calculation. In connection with its investment in NYMT, in January 2008, the Company entered into an advisory agreement between HCS and NYMT.

| | Three Months Ended September 30, 2009 | | | Nine Months Ended September 30, 2009 | | |
|---|---|---------------------|---------------------|---|---------------------|---------------------|
| | Company's Share of Change in Fair Value | HCS Management Fee | HCS Incentive Fee | Company's Share of Change in Fair Value | HCS Management Fee | HCS Incentive Fee |
| Hedge Funds: | | | | | | |
| Harvest Opportunity Partners II | \$ 1,145,572 | \$ 142,304 | \$ 687,538 | \$ 1,943,982 | \$ 432,377 | \$ 931,072 |
| Harvest Small Cap Partners | (342,371) | 1,547,654 | 2,476 | 1,676,972 | 4,311,842 | 7,942,974 |
| Harvest Consumer Partners | 229,306 | 18,251 | 34,423 | 538,693 | 39,110 | 73,142 |
| Harvest Technology Partners | (57,678) | 40,274 | (6) | 1,186,143 | 83,842 | 184,434 |
| Harvest Mortgage Opportunities Partners (1) | 479,660 | 50,328 | | 1,719,384 | 155,745 | |
| Harvest Global Select Partners | 6,330 | 17,543 | 1,771 | 19,236 | 26,356 | 7,613 |
| Funds of Funds: | | | | | | |
| JMP Masters Fund | 107,970 | 220,789 | | 190,638 | 657,871 | |
| JMP Emerging Masters Fund | 14,188 | 24,906 | | 40,324 | 73,351 | |
| REITs: | | | | | | |
| New York Mortgage Trust | 1,731,347 | 179,281 | 334,096 | 4,203,622 | 544,402 | 378,021 |
| Totals | \$ 3,314,324 | \$ 2,241,330 | \$ 1,060,298 | \$ 11,518,994 | \$ 6,324,896 | \$ 9,517,256 |

(1)

Edgar Filing: JMP Group Inc. - Form 10-Q

Revenues earned from HMOP are consolidated and then eliminated in consolidation in the Company's Statements of Operations, net of noncontrolling interest.

Table of Contents

| | Three Months Ended September 30, 2008 | | | Nine Months Ended September 30, 2008 | | |
|---------------------------------|--|-----------------------|----------------------|--|-----------------------|----------------------|
| | Company's Share of Change in Fair Value | HCS Management Fee | HCS Incentive Fee | Company's Share of Change in Fair Value | HCS Management Fee | HCS Incentive Fee |
| Hedge Funds: | | | | | | |
| Harvest Opportunity Partners II | \$ (139,977) | \$ 161,855 | \$ | \$ (670,350) | \$ 529,389 | \$ 38,777 |
| Harvest Small Cap Partners | 729,378 | 917,325 | 641,244 | 1,593,400 | 1,871,229 | 2,294,676 |
| Harvest Consumer Partners (1) | 47,677 | 7,410 | | 63,211 | 20,300 | 2,010 |
| Harvest Technology Partners (1) | (105,138) | 10,158 | | 77,785 | 23,994 | 21,413 |
| Funds of Funds: | | | | | | |
| JMP Masters Fund | 9,497 | 300,831 | 2,750 | 108,275 | 871,716 | 33,573 |
| JMP Emerging Masters Fund | (15,893) | 26,085 | 129 | (31,889) | 79,391 | 9,276 |
| REITs: | | | | | | |
| JMP Realty Trust (1) | (424,960) | 63,799 | | (538,030) | 198,670 | |
| New York Mortgage Trust | (2,238,619) | 185,917 | | (3,375,639) | 478,980 | |
| Totals | \$ (2,138,035) | \$ 1,673,380 | \$ 644,123 | \$ (2,773,237) | \$ 4,073,669 | \$ 2,399,725 |

(1) Revenues earned from HTP, HCP and JMPRT are consolidated and then eliminated in consolidation in the Company's Statements of Operations, net of noncontrolling interest.

With the acquisition of Cratos, we earn management fees at JMP Credit Corporation (JMP Credit) as the asset manager for a corporate loan securitization structure (CLO). During the quarter ended September 30, 2009, we earned management fees of \$627,131 or 50 bps annualized on gross assets under management. At September 30, 2009, gross assets under management were \$498.4 million. As we consolidate the CLO, the management fees for GAAP are eliminated in consolidation.

Principal Transactions

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

Gain on Sale and Payoff of Loans

Gain on sale and payoff of loans consists of gains from the sale and payoff of loans collateralizing asset-backed securities at JMP Credit. Gains are recorded when the proceeds exceed the carrying value of the loan.

Gain on Repurchase of Asset-Backed Securities Issued

Gain on repurchase of asset-backed securities issued (ABS) consists of gains from repurchases of our ABS from third parties. Gains are recorded when the repurchase price is less than the carrying value of the ABS.

Gain on Bargain Purchase

A bargain purchase gain was recognized upon the acquisition of Cratos by JMP Credit on April 7, 2009. This represents the difference between the fair value of net assets acquired and the consideration to the sellers.

Net Dividend Income

Net dividend income comprises dividends from our investments offset by dividend expense for paying short positions in our principal investment portfolio.

Other Income

Edgar Filing: JMP Group Inc. - Form 10-Q

Other income includes loan restructuring fees at JMP Credit and revenues from fee sharing arrangements with, and fees earned to raise capital for third-party investment partnerships, or funds.

Interest Income

Interest income primarily consists of interest income earned on loans. Interest income on loans comprises the stated coupon as a percentage of the face amount receivable as well as accretion of accretable or purchase discounts and deferred fees and costs. Interest income is recorded on the accrual basis in accordance with the terms of the respective loans unless such loans are placed on non-accrual status.

Interest Expense

Interest expense primarily consists of interest expense incurred on asset-backed securities issued and note payable. Interest expense on asset-backed securities is the stated coupon payable as a percentage of the principal amount as well as amortization of liquidity discount which was recorded at the acquisition date of Cratos. Interest expense is recorded on the accrual basis in accordance with the terms of the respective asset-backed securities issued and note payable.

Table of Contents

Provision for Loan Losses

Loss provision on loans held for investment includes reserves recognized on our loan notes and non-revolving credit agreements (collectively loans held for investment) and loans collateralizing ABS (at JMP Credit) to record them at their net realizable value. The Company maintains an allowance for loan losses that is intended to estimate loan losses inherent in its loan portfolio. A provision for loan losses is charged to expense to establish the allowance for loan losses. The allowance for loan losses is maintained at a level, in the opinion of management, sufficient to offset estimated losses inherent in the loan portfolio as of the date of the financial statements. The appropriateness of the allowance and the allowance components are reviewed quarterly. The Company's estimate of each allowance component is based on observable information and on market and third party data that the Company believes are reflective of the underlying loan losses being estimated.

Components of Expenses

We classify our expenses as compensation and benefits, administration, brokerage, clearing and exchange fees and other expenses. A significant portion of our expense base is variable, including compensation and benefits, brokerage and clearance, communication and technology and travel and business development expenses.

Compensation and Benefits

Compensation and benefits is the largest component of our expenses and includes employees' base pay, performance bonuses, sales commissions, related payroll taxes, medical and benefits expenses, as well as expenses for contractors, temporary employees and equity-based compensation. Our employees receive a substantial portion of their compensation in the form of individual performance-based bonuses. As is the widespread practice in our industry, we pay bonuses on an annual basis, which for senior professionals typically make up a large portion of their total compensation. Bonus payments may have a greater impact on our cash position and liquidity in the periods in which they are paid than would otherwise be reflected in our Consolidated Statements of Operations. We accrue for the estimated amount of these bonus payments ratably over the applicable service period.

Compensation is accrued using specific ratios of total compensation and benefits to total revenues based on revenue categories, as adjusted if, in management's opinion such adjustments are necessary and appropriate to maintain competitive compensation levels.

Administration

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

Brokerage, Clearing and Exchange Fees

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

Other Expenses

Other operating expenses primarily include travel and business development, market data, occupancy, legal and accounting professional fees, depreciation and CLO administration expense at JMP.

Noncontrolling Interest

Noncontrolling interest for the three and nine months ended September 30, 2009 includes the interest of third parties in JMP Credit, Harvest Mortgage Opportunities Partners (HMOP), and Opportunity Acquisition Corp. (SPAC), partially-owned subsidiaries consolidated on our books. Noncontrolling interest for the three and nine months ended September 30, 2008 relates to the interest of third parties in SPAC, JMP Realty Trust (JMPRT), and in two of our asset management funds, Harvest Consumer Partners (HCP) and Harvest Technology Partners (HTP). JMPRT was a real estate investment trust that was formed in June 2006. Because of the ownership and external management position, we consolidated JMP Realty Trust and recorded a noncontrolling interest through December 31, 2008. On January 2, 2009, all of the assets and liabilities of JMPRT were transferred to HMOP, a newly-formed hedge fund managed by HCS. The partnership agreements for HMOP provide for the right of the limited partners to remove the general partners by a simple majority vote of the non-affiliated limited partners. The Company follows the

Edgar Filing: JMP Group Inc. - Form 10-Q

authoritative guidance under GAAP regarding the determination of 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. Such guidance applies when a general partner controls a limited partnership and is required to consolidate the limited partnership in its financial statements. Under the guidance, the general partner in a limited partnership is presumed to control the limited partnership regardless of the extent of the general partners' ownership interest in the limited partnership. If the limited partners have either (a) the substantive ability to liquidate the limited partnership or otherwise remove the general partner without cause or (b) substantive participating rights, the general partner does not control the limited partnership. The partnership agreements for HMOP provide for the right of the limited partners to remove the general partner by a simple majority vote of the non-affiliated limited partners. Because of these substantive kick-out rights, the Company, as the general partner, did not control HMOP and therefore did not consolidate HMOP from January 2, 2009 through April 30, 2009. During the quarter ended June 30, 2009, several non-affiliated limited partners redeemed their interest in HMOP, and the remaining limited partners were no longer deemed to have substantive kick-out rights. As a result, the Company consolidates HMOP in its consolidated financial statements effective May 1, 2009.

Table of Contents

HCS is also the general partner of Harvest Consumer Partners and Harvest Technology Partners. As of December 31, 2007 and during part of 2008 due to our ownership and resulting control by HCS and related parties, management believes that limited partners did not have substantive rights to remove the general partner, and, therefore, these two funds were consolidated in the financial statements and noncontrolling interest was recorded. During 2008, additional limited partners invested in HTP and HCP, and effective August 1, 2008 for HTP and December 1, 2008 for HCP, the limited partners had substantive rights to remove the general partner and the funds were deconsolidated as of the respective dates.

Results of Operations

The following table sets forth our results of operations for the three and nine month periods ended September 30, 2009 and 2008 and is not necessarily indicative of the results to be expected for any future period.

| <i>(in thousands)</i> | Three Months Ended September 30, | | Change from | |
|---|----------------------------------|---------------|---------------|---------------|
| | 2009 | 2008 | \$ | % |
| Revenues | | | | |
| Investment banking | \$ 10,391 | \$ 4,879 | \$ 5,512 | 113.0% |
| Brokerage | 7,939 | 9,574 | (1,635) | -17.1% |
| Asset management fees | 3,266 | 2,292 | 974 | 42.5% |
| Principal transactions | 5,981 | (2,726) | 8,707 | N/A |
| Gain on sale and payoff of loans | 6,727 | | 6,727 | N/A |
| Gain on repurchase of asset-backed securities issued | 4,096 | | 4,096 | N/A |
| Gain on bargain purchase | | | | N/A |
| Net dividend income | 766 | 939 | (173) | -18.4% |
| Other income | 227 | 214 | 13 | 6.1% |
| Non-interest revenues | 39,393 | 15,172 | 24,221 | 159.6% |
| Interest income | 12,214 | 654 | 11,560 | 1767.6% |
| Interest expense | (8,504) | (102) | (8,402) | 8237.3% |
| Net interest income | 3,710 | 552 | 3,158 | 572.1% |
| Provision for loan losses | (1,384) | (428) | (956) | 223.4% |
| Total net revenues after provision for loan losses | 41,719 | 15,296 | 26,423 | 172.7% |
| Non-interest Expenses | | | | |
| Compensation and benefits | 29,308 | 17,724 | 11,584 | 65.4% |
| Administration | 1,098 | 1,257 | (159) | -12.6% |
| Brokerage, clearing and exchange fees | 1,317 | 1,389 | (72) | -5.2% |
| Other | 3,436 | 3,165 | 271 | 8.6% |
| Total non-interest expenses | 35,159 | 23,535 | 11,624 | 49.4% |
| Income (loss) before income tax expense | 6,560 | (8,239) | 14,799 | N/A |
| Income tax expense (benefit) | 2,879 | (2,971) | 5,850 | N/A |
| Net income (loss) | 3,681 | (5,268) | 8,949 | N/A |
| Less: Net income (loss) attributable to the noncontrolling interest | 712 | (369) | 1,081 | N/A |
| Net income (loss) attributable to JMP Group Inc. | \$ 2,969 | \$ (4,899) | \$ 7,868 | N/A |

Table of Contents

| <i>(in thousands)</i> | Nine Months Ended September 30, | | Change from | |
|---|---------------------------------|-------------------|------------------|----------------|
| | 2009 | 2008 | \$ | % |
| Revenues | | | | |
| Investment banking | \$ 25,104 | \$ 23,819 | \$ 1,285 | 5.4% |
| Brokerage | 25,836 | 26,433 | (597) | -2.3% |
| Asset management fees | 15,766 | 6,365 | 9,401 | 147.7% |
| Principal transactions | 15,403 | (4,789) | 20,192 | N/A |
| Gain on sale and payoff of loans | 11,571 | | 11,571 | N/A |
| Gain on repurchase of asset-backed securities issued | 4,205 | | 4,205 | N/A |
| Gain on bargain purchase | 1,179 | | 1,179 | N/A |
| Net dividend income | 1,850 | 2,460 | (610) | -24.8% |
| Other income | 1,154 | 923 | 231 | 25.0% |
| Non-interest revenues | 102,068 | 55,211 | 46,857 | 84.9% |
| Interest income | 24,172 | 1,860 | 22,312 | 1199.6% |
| Interest expense | (17,484) | (298) | (17,186) | 5767.1% |
| Net interest income | 6,688 | 1,562 | 5,126 | 328.2% |
| Provision for loan losses | (5,366) | (428) | (4,938) | 1153.7% |
| Total net revenues after provision for loan losses | 103,390 | 56,345 | 47,045 | 83.5% |
| Non-interest Expenses | | | | |
| Compensation and benefits | 70,849 | 44,148 | 26,701 | 60.5% |
| Administration | 3,541 | 4,610 | (1,069) | -23.2% |
| Brokerage, clearing and exchange fees | 4,057 | 3,859 | 198 | 5.1% |
| Other | 9,936 | 10,453 | (517) | -4.9% |
| Total non-interest expenses | 88,383 | 63,070 | 25,313 | 40.1% |
| Income (loss) before income tax expense | 15,007 | (6,725) | 21,732 | N/A |
| Income tax expense (benefit) | 6,491 | (2,485) | 8,976 | N/A |
| Net income (loss) | 8,516 | (4,240) | 12,756 | N/A |
| Less: Net income (loss) attributable to the noncontrolling interest | 1,227 | (215) | 1,442 | N/A |
| Net income (loss) attributable to JMP Group Inc. | \$ 7,289 | \$ (4,025) | \$ 11,314 | N/A |

Table of Contents

Three Months Ended September 30, 2009, Compared to Three Months Ended September 30, 2008

Overview

Total net revenues after provision for loan losses increased \$26.4 million, or 172.7%, from \$15.3 million for the quarter ended September 30, 2008 to \$41.7 million for the quarter ended September 30, 2009, driven by an increase in non-interest revenues of \$24.2 million and an increase in net interest income of \$3.2 million, offset by an increase in provision for loan losses of \$1.0 million.

Non-interest revenues increased \$24.2 million or 159.6% primarily due to a \$8.7 million increase in principal transaction revenues, a \$6.7 million increase in asset management revenues, a \$5.5 million increase in investment banking revenues and a \$4.1 million increase in gain on repurchase of asset-backed securities issued.

Net interest income increased \$3.2 million or 572.1%, from \$0.5 million for the quarter ended September 30, 2008 to \$3.7 million for the same period in 2009. The increase was due to the acquisition of Cratos which resulted in \$3.6 million of net interest income recorded at JMP Credit.

Provision for loan losses increased from \$0.4 million for the quarter ended September 30, 2008 to \$1.4 million for the quarter ended September 30, 2009 primarily due to \$1.5 million recorded against loans collateralizing ABS issued.

Total non-interest expenses increased \$11.6 million, or 49.4%, from \$23.5 million for the quarter ended September 30, 2008 to \$35.1 million for the quarter ended September 30, 2009, primarily due to an increase in compensation and benefits of \$11.6 million.

Net income (loss) attributable to JMP Group Inc. increased \$7.9 million from net loss of \$4.9 million for the quarter ended September 30, 2008 to net income of \$3.0 million for the quarter ended September 30, 2009, primarily as a result of the aforementioned increase in net revenues after provision for loan losses partially offset by the aforementioned increase in non-interest expenses and a \$5.9 million increase in income tax expense from a benefit of \$3.0 million for the quarter ended September 30, 2008 to an expense of \$2.9 million for the quarter ended September 30, 2009.

Revenues

Investment Banking

Investment banking revenues increased \$5.5 million, or 113%, from \$4.9 million for the quarter ended September 30, 2008 to \$10.4 million for the same period in 2009, and decreased as a percentage of total net revenues after provision for loan losses from 31.9% to 24.9%, respectively. The increase in revenues reflects a higher level of activity in our public equity underwriting and private placement business, partially offset by decreased activity in our strategic advisory businesses. Public equity underwriting revenues increased by \$6.3 million, from \$0.2 million for the quarter ended September 30, 2008 to \$6.5 million for the quarter ended September 30, 2009. We executed 12 public equity underwriting transactions in the quarter ended September 30, 2009 compared to one in the quarter ended September 30, 2008. We acted as a lead manager on one transaction in the quarter ended September 30, 2009 and none in the same period in 2008. Private placement revenues increased \$1.1 million from \$0.2 million for the quarter ended September 30, 2008 to \$1.3 million for the quarter ended September 30, 2009. We executed two private placement transactions in the quarter ended September 30, 2009 compared to none in the quarter ended September 30, 2008. Our strategic advisory revenues decreased \$1.9 million, or 42.4%, from \$4.5 million for the quarter ended September 30, 2008 to \$2.6 million for the quarter ended September 30, 2009. We executed three strategic advisory transactions in the quarter ended September 30, 2009 compared to five in the quarter ended September 30, 2008.

Brokerage Revenues

Brokerage revenues decreased by \$1.7 million, or 17.1%, from \$9.6 million for the quarter ended September 30, 2008 to \$7.9 million for the quarter ended September 30, 2009. The decrease was the result of lower gross commissions, which is a function of a decrease in overall average daily volume in the markets in which we transact; overall average daily volume in the NYSE and Nasdaq Composite Indices combined decreased 4.7 % from the third quarter 2008 to the third quarter 2009. Brokerage revenues decreased as a percentage of total net revenues after provision for loan losses, from 62.6% for the quarter ended September 30, 2008 to 19.0% for the quarter ended September 30, 2009.

Asset Management Fees

Edgar Filing: JPM Group Inc. - Form 10-Q

Asset management fees increased \$1.0 million, or 42.5%, from \$2.3 million for the quarter ended September 30, 2008 to \$3.3 million for the quarter ended September 30, 2009. Asset management fees include base management fees and incentive fees for our funds under management. Base management fees increased from \$1.7 million for the third quarter of 2008 to \$2.2 million for the same period in 2009. Incentive fees increased from \$0.6 million for the third quarter of 2008 to \$1.1 million for the same period in 2009. The increase in base management fees was the result of an increase in client assets under management from \$450.1 million as of September 30, 2008 to \$553.0 million as of September 30, 2009. In particular, client assets under management for Harvest Small Cap Partners fund increased from \$206.9 million at September 30, 2008 to \$310.4 million at September 30, 2009. The increase in incentive fees is due to the improved performance of our families of funds, in particular of Harvest Opportunity Partners II, as well as improved performance of NYMT. As a percentage of total net revenues after provision for loan losses, asset management fees decreased from 15.0% for the quarter ended September 30, 2008 to 7.8% for the same period in 2009.

Table of Contents*Principal Transactions*

Principal transaction revenues increased \$8.7 million from a loss of \$2.7 million for the quarter ended September 30, 2008 to a gain of \$6.0 million for the quarter ended September 30, 2009. The increase was primarily due to a \$8.1 million increase in equity and other security principal transaction revenues from a loss of \$3.2 million for the third quarter of 2008 to a gain of \$4.9 million for the third quarter of 2009. In addition, gain on investments in partnerships increased \$0.6 million from \$0.5 million for the third quarter of 2008 to \$1.1 million for the third quarter of 2009. The \$8.1 million increase in equity and other security transaction revenues included a \$5.4 million increase in unrealized gain/loss on our convertible preferred security and equity security investments in NYMT, which reflected a loss of \$3.1 million for the third quarter of 2008 compared to a gain of \$2.3 million for the third quarter of 2009.

Gain on Sale and Payoff of Loans

Gain on sale and payoff of loans increased \$6.7 million from zero for the quarter ended September 30, 2008 to \$6.7 million for the same period in 2009, with all of the gain generated at JMP Credit. During the quarter ended September 30, 2009, six loans were sold or repaid (including one partially sold), with two loan repayments contributing \$4.8 million of the net \$6.7 million of gain, where the borrowers repaid the loans at a premium to our carrying value.

Gain on Repurchase of Asset-Backed Securities Issued

Gain on repurchase of ABS issued increased \$4.1 million from zero for the quarter ended September 30, 2008 to \$4.1 million for the same period in 2009, with all of the gain generated at JMP Credit. The majority of the gain resulted from a repurchase in July 2009 in the open market of \$4.0 million par value of our ABS at a discount, resulting in a gain of \$3.5 million.

Net Dividend Income

Net dividend income decreased \$0.1 million or 18.4% from \$0.9 million for the quarter ended September 30, 2008 to \$0.8 million for the quarter ended September 30, 2009. The decrease was primarily due to lower net dividends in our principal investment portfolio.

Other Income

Other income was \$0.2 million for the quarters ended September 30, 2008 and 2009. For the quarter ended September 30, 2008, other income was primarily comprised of revenues from fee sharing arrangements with, and fees earned to raise capital for, third-party investment partnerships or funds. For the quarter ended September 30, 2009, other income was comprised of these previously mentioned revenues plus loan restructuring fees at JMP Credit.

Interest Income

Interest income increased \$11.6 million from \$0.6 million for the quarter ended September 30, 2008 to \$12.2 million for the same period in 2009. The increase was primarily due to the acquisition of Cratos which resulted in \$12.0 million of interest income at JMP Credit for the quarter ended September 30, 2009.

At JMP Credit, total interest income of \$12.0 million was mainly comprised of interest earned on our 84 performing loans of \$4.6 million, amortization of purchase discounts and other deferred fees of \$0.4 million and the non-cash amortization of the liquidity discounts on our loans of \$7.0 million. The annualized weighted average interest rate on the loans was 4.83% with a spread to weighted average LIBOR of 4.18% for the quarter ended September 30, 2009. The Company did not recognize any interest income for the 15 impaired loans with an aggregate weighted average loan balance of \$103.8 million that were on non-accrual status during the quarter.

Interest Expense

Interest expense increased \$8.4 million from \$0.1 million for the quarter ended September 30, 2008 to \$8.5 million for the same period in 2009. The increase was due to the acquisition of Cratos which resulted in \$8.4 million of interest expense at JMP Credit.

At JMP Credit, interest expense of \$8.4 million was comprised of \$1.5 million in interest expense on ABS issued, \$6.8 million in non-cash amortization of the liquidity discount on the ABS issued, and \$0.1 million in interest primarily on the contingent consideration. The annualized weighted average cost of funds for the ABS issued during the quarter was 1.34% with a spread to weighted average LIBOR of 0.70%.

Provision for Loan Losses

Provision for loan losses increased \$1.0 million from \$0.4 million for the quarter ended September 30, 2008 to \$1.4 million for the same period in 2009. The increase related to loans collateralizing ABS issued at JMP Credit. There was no provision recorded for loans held for investment in the quarter ended September 30, 2009 compared to \$0.4 million recorded in the quarter ended September 30, 2008. At JMP Credit \$1.5 million of loan loss provision was primarily \$1.4 million of additional provision recorded during the quarter as specific reserves against impaired loans. This was in addition to the credit discount recorded against impaired loans at the acquisition date of Cratos to record the impaired loans at their net realizable value. In addition, provision of \$0.1 million was recorded as pooled reserve against performing loans as of September 30, 2009 at JMP Credit.

Table of Contents**Expenses***Compensation and Benefits*

Compensation and benefits, which includes employee payroll, taxes and benefits, performance-based cash bonus and commissions as well as equity-based compensation to our employees and managing directors, increased \$11.6 million, or 65.4%, from \$17.7 million for the quarter ended September 30, 2008 to \$29.3 million for the quarter ended September 30, 2009.

Employee payroll, taxes and benefits, and consultant fees, increased \$0.4 million, or 4.9%, from \$7.3 million for the quarter ended September 30, 2008 to \$7.7 million for the quarter ended September 30, 2009 primarily due to the acquisition of Cratos.

Performance-based cash bonus and commission increased \$12.0 million, or 143.5%, from \$8.3 million for the quarter ended September 30, 2008 to \$20.3 million for the quarter ended September 30, 2009 primarily due to higher net revenues for the quarter ended September 30, 2009 compared to the quarter ended September 30, 2008. Total net revenues after provision for loan losses increased \$26.4 million or 172.7% from \$15.3 million for the quarter ended September 30, 2008 to \$41.8 million for the quarter ended September 30, 2009. In addition, the Company recorded a performance-based bonus accrual for senior management of \$6.8 million in the quarter ended September 30, 2009.

Equity-based compensation decreased \$0.8 million, or 37.8%, from \$2.0 million for the quarter ended September 30, 2008 to \$1.2 million for the quarter ended September 30, 2009 primarily due the acceleration of the vesting of restricted stock units (RSUs) granted under our 2007 bonus compensation program on December 22, 2008. As a result of the acceleration, the Company recognized \$2.6 million of amortization expense from future periods in the year ended December 31, 2008, thus eliminating the amortization expense on those RSUs that would have been recognized in the future periods, including the quarter ended September 30, 2009. The total equity-based compensation expense for the quarter ended September 30, 2009 and 2008 included \$0.7 million and \$0.8 million, respectively, recognized for RSUs granted in connection with the initial public offering and \$0.5 million and \$1.2 million, respectively, recognized for RSUs granted after the initial public offering.

Compensation and benefits as a percentage of revenues decreased from 115.9% of total net revenues after provision for loan losses for the quarter ended September 30, 2008 to 70.3% for the same period in 2009. This was due to an increase in net interest income, gain on sale and payoff of loans and gain on repurchase of ABS, for which we accrue performance-based bonus at a lower rate than other types of revenues. In addition for the quarter ended September 30, 2008 there was the application of our target compensation to revenue ratios to decreased revenues used for the accrual of bonuses, as adjusted by management to maintain competitive compensation levels to employees. This created higher compensation and benefits as a percentage of revenues as compared to the same period for 2009. Excluding expense from RSUs granted in connection with the initial public offering of \$0.8 million and \$0.7 million for the quarters ended September 30, 2008 and 2009, as a percentage of total net revenues after provision for loan losses, compensation and benefits decreased from 110.7% of total revenues for the quarter ended September 30, 2008 to 68.6% for the same period in 2009.

Administration

Administration expenses decreased \$0.2 million, or 12.6%, from \$1.3 million for the quarter ended September 30, 2008 to \$1.1 million for the quarter ended September 30, 2009. The decrease was primarily due to lower hiring expenses in the third quarter 2009 compared to the same period in 2008. As a percentage of total net revenues after provision for loan losses, administration expense decreased from 8.2% of total net revenues after provision for loan losses for the quarter ended September 30, 2008 to 2.6% for the same period in 2009 as a result of higher total net revenues after provision for loan losses in 2009 compared to 2008.

Brokerage, Clearing and Exchange Fees

Brokerage, clearing and exchange fees decreased \$0.1 million, or 5.2%, from \$1.4 million for the quarter ended September 30, 2008 to \$1.3 million for the quarter ended September 30, 2009. The decrease was primarily due to a decrease in the number of shares traded in the quarter ended September 30, 2009 compared to the quarter ended September 30, 2008. As a percentage of total net revenues after provision for loan losses, our brokerage, clearing and exchange fees decreased from 9.1% for the quarter ended September 30, 2008 to 3.2% for the same period in 2009.

Other Expenses

Other expenses increased \$0.3 million, or 8.6%, from \$3.2 million for the quarter ended September 30, 2008 to \$3.5 million for the quarter ended September 30, 2009. As a percentage of total net revenues after provision for loan losses, other expenses decreased from 20.7% for the quarter ended September 30, 2008 to 8.2% for the same period in 2009 as a result of higher revenues in 2009 compared to the same period in

2008.

Net Income (Loss) Attributable to Noncontrolling Interest

Net income (loss) attributable to noncontrolling interest increased \$1.1 million from net loss of \$0.4 million for the three months ended September 30, 2008 to net income of \$0.7 million for the three months ended September 30, 2009. Noncontrolling interest for the three months ended September 30, 2009 includes the interest of third parties in JMP Credit, Harvest Mortgage Opportunities Partners (HMOP), and Opportunity Acquisition Corp. (SPAC), partially-owned subsidiaries consolidated on our books. Noncontrolling interest for the three months ended September 30, 2008 relates to the interest of third parties in SPAC, JMP Realty Trust (JMPRT), and in two of our asset management funds, Harvest Consumer Partners (HCP) and Harvest Technology Partners (HTP). Because of the ownership and external management position which did not provide the limited partners with substantive rights to remove the general partner, we consolidated JMPRT, HCP and HTP through December 31, 2008, November 30, 2008 and July 31, 2008, respectively, and recorded noncontrolling interest. Additional limited partners invested in HTP and HCP during 2008 and the limited partners had substantive rights to remove the general partner effective August 1, 2008 for HTP and December 1, 2008 for HCP. As a result, we deconsolidated HTP and HCP as of the respective effective date. The assets and liabilities of JMPRT were transferred to HMOP effective January 2, 2009. Because of the limited partners' substantive kick-out rights, HMOP was not required to be consolidated from January 2, 2009 through April 30, 2009. During the quarter ended June 30, 2009, several non-affiliated limited partners redeemed their interest in HMOP, and the remaining limited partners were no longer deemed to have substantive kick-out rights. As a result, the Company consolidated HMOP in its consolidated financial statements effective May 1, 2009.

Table of Contents

Provision for Income Taxes

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

In connection with our initial public offering and Reorganization, we became subject to federal and state income taxes on all taxable income earned subsequent to May 15, 2007. Additionally, in connection with the Reorganization, we recognized a one-time tax benefit of \$4.0 million in connection with the establishment of net deferred tax asset items of \$10.2 million. In calculating the one-time tax benefit amount and associated deferred tax asset items, the Company made reasonable estimates of its share of the 2006 taxable income and 2007 taxable income attributed to the period from January 1 through May 15, 2007 of the partnerships in which it has a direct or indirect interest.

For the three months ended September 30, 2009 and 2008, we recorded tax expense of \$2.9 million and tax benefit of \$3.0 million, respectively.

The effective tax rate for the three months ended September 30, 2009 and 2008 was 43.9% and 37.7%, respectively.

Nine Months Ended September 30, 2009, Compared to Nine Months Ended September 30, 2008

Overview

Total net revenues after provision for loan losses increased \$47.1 million, or 83.5%, from \$56.3 million for the nine months ended September 30, 2008 to \$103.4 million for the nine months ended September 30, 2009, driven by an increase in non-interest revenues of \$46.9 million and increase in net interest income of \$5.1 million, offset by an increase in provision for loan losses of \$4.9 million.

Non-interest revenues increased \$46.9 million or 84.9% primarily due to a \$20.2 million increase in principal transaction revenues, a \$9.4 million increase in asset management revenues and a \$11.6 million increase in gain on sale and payoff of loans.

Net interest income increased \$5.1 million or 328.2% from \$1.6 million for the nine months ended September 30, 2008 to \$6.7 million for the same period in 2009. The increase was due to the acquisition of Cratos and primarily \$6.4 million of net interest income recorded at JMP Credit. Net interest income for the remainder of the Company fell from \$1.6 million to \$0.3 million primarily due to lower interest received on cash balances during the nine months ended September 30, 2009 compared to the same period in 2008.

Provision for loan losses increased \$5.0 million from \$0.4 million for the nine months ended September 30, 2008 to \$5.4 million for the nine months ended September 30, 2009 due to \$1.4 million recorded against loans held for investment and \$4.0 million recorded against loans collateralizing ABS issued at JMP Credit.

Total non-interest expenses increased \$25.3 million, or 40.1%, from \$63.1 million for the nine months ended September 30, 2008 to \$88.4 million for the nine months ended September 30, 2009, primarily due to an increase in compensation and benefits of \$26.7 million offset by a decrease in administration expense of \$1.1 million and a decrease in other expenses of \$0.5 million.

Net income (loss) attributable to JMP Group Inc. increased \$11.3 million from net loss of \$4.0 million for the nine months ended September 30, 2008 to net income of \$7.3 million for the nine months ended September 30, 2009, and includes \$9.0 million increase in income tax expense from tax benefit of \$2.5 million for the nine months ended September 30, 2008 to tax expense of \$6.5 million for the nine months ended September 30, 2009.

Revenues

Investment Banking

Investment banking revenues increased \$1.3 million, or 5.4%, from \$23.8 million for the nine months ended September 30, 2008 to \$25.1 million for the same period in 2009, and decreased as a percentage of total net revenues after provision for loan losses from 42.3% to 24.3%, respectively. The increase in revenues reflects a higher level of activity in our public equity underwriting, partially offset by a decrease in revenues from our private placement business and strategic advisory businesses. Public equity underwriting revenues increased by \$4.5 million, or 59.4%, from \$7.5 million for the nine months ended September 30, 2008 to \$12.0 million for the nine months ended September 30, 2009. We

Edgar Filing: JMP Group Inc. - Form 10-Q

executed 21 public equity underwriting transactions in the nine months ended September 30, 2009 compared to 14 in the nine months ended September 30, 2008. We acted as a lead manager on two transactions in the nine-month period ended September 30, 2009 compared to none in the same period in 2008. Private placement revenues decreased \$2.9 million, or 41.3%, from \$7.1 million for the nine months ended September 30, 2008 to \$4.2 million for the nine months ended September 30, 2009 primarily due to a decrease in the average revenue per transaction executed. Our strategic advisory revenues decreased \$0.3 million, or 2.9%, from \$9.2 million for the nine months ended September 30, 2008 to \$8.9 million for the nine months ended September 30, 2009, due to fewer transactions executed. We executed 10 strategic advisory transactions in the nine months ended September 30, 2009 compared to 11 in the nine months ended September 30, 2008.

Brokerage Revenues

Brokerage revenues decreased by \$0.6 million, or 2.3%, from \$26.4 million for the nine months ended September 30, 2008 to \$25.8 million for the nine months ended September 30, 2009. The decrease was the result of lower gross commissions. Brokerage revenues decreased as a percentage of total revenues, from 46.9% for the nine months ended September 30, 2008 to 25.0% for the nine months ended September 30, 2009.

Table of Contents*Asset Management Fees*

Asset management fees increased \$9.4 million, or 147.7%, from \$6.4 million for the nine months ended September 30, 2008 to \$15.8 million for the nine months ended September 30, 2009. Asset management fees include base management fees and incentive fees for our funds under management. Base management fees increased from \$4.0 million for the first nine months of 2008 to \$6.3 million for the same period in 2009. Incentive fees increased from \$2.4 million for the first nine months of 2008 to \$9.5 million for the same period in 2009. The increase in base management fees is the result of an increase in client assets under management from \$450.1 million as of September 30, 2008 to \$553.0 million as of September 30, 2009. This was primarily due to the performance of Harvest Small Cap Partners during 2008 as well as the first two quarters of 2009, which enabled it to raise additional capital and increase client assets under management from \$206.9 million at September 30, 2008 to \$310.4 million at September 30, 2009. The increase in incentive fees is due to the improved performance of our families of funds, in particular the performance of Harvest Small Cap Partners fund. As a percentage of total net revenues after provision for loan losses, asset management fees increased from 11.3% for the nine months ended September 30, 2008 to 15.3% for the same period in 2009.

Principal Transactions

Principal transaction revenues increased \$20.2 million from a loss of \$4.8 million for the nine months ended September 30, 2008 to a gain of \$15.4 million for the nine months ended September 30, 2009. The increase was primarily due to a \$15.4 million increase in equity and other security transaction revenues from a loss of \$6.0 million for the first nine months of 2008 to a gain of \$9.4 million for the first nine months of 2009. In addition, gain on investments in partnerships increased \$5.0 million from \$1.1 million for the first nine months of 2008 to \$6.1 million for the first nine months of 2009. The \$15.4 million increase in equity and other security transaction revenues was to a large extent related to an increase of \$10.5 million in unrealized gain/loss on our convertible preferred security and equity security investments in NYMT, which reflected a loss of \$4.9 million for the first nine months of 2008 compared to a gain of \$5.6 million for the first nine months of 2009.

Gain on Sale and Payoff of Loans

Gain on sale and payoff of loans increased \$11.6 million from zero for the nine months ended September 30, 2008 to \$11.6 million for the same period in 2009, with all of the gain generated at JMP Credit. During the nine months ended September 30, 2009, 12 loans were sold or repaid (including one partially sold), with three loan repayments contributing \$9.5 million of the net \$11.6 million of gain, where the borrowers repaid the loans at a premium to our carrying value.

Gain on Repurchase of Asset-Backed Securities Issued

Gain on repurchase of ABS issued increased \$4.2 million from zero for the nine months ended September 30, 2008 to \$4.2 million for the same period in 2009, with all of the gain generated at JMP Credit. In May and July 2009, we repurchased in the open market \$0.8 million and \$4.0 million of face value, respectively, of our ABS at a discount resulting in a gain of \$4.2 million.

Gain on Bargain Purchase

Upon the acquisition of Cratos by JMP Credit on April 7, 2009, a bargain purchase gain of \$1.2 million was recorded which reflects the difference between the fair value of net assets acquired of \$7.5 million and the GAAP consideration to the sellers of \$6.3 million. In accordance with ASC 805-10 this gain was booked to current period revenues.

Net Dividend Income

Net dividend income decreased \$0.6 million, or 24.8%, from \$2.5 million for the nine months ended September 30, 2008 to \$1.9 million for the quarter ended September 30, 2009. The decrease was primarily due to higher dividend expense on short positions in our principal investment portfolio.

Other Income

Other income increased \$0.2 million from \$0.9 million for the nine months ended September 30, 2008 to \$1.1 million for the same period in 2009. The increase comprised loan restructuring fees of \$0.6 million at JMP Credit, offset by a \$0.4 million decrease in revenues from fee sharing arrangements with, and fees earned to raise capital for, third-party investment partnerships or funds.

Edgar Filing: JMP Group Inc. - Form 10-Q

Interest Income

Interest income increased \$22.3 million from \$1.9 million for the nine months ended September 30, 2008 to \$24.2 million for the same period in 2009. The increase was due to the acquisition of Cratos and primarily \$23.6 million of interest income at JMP Credit offset by a fall in interest income at the remainder of the Company of \$1.3 million due to lower interest received on cash balances.

At JMP Credit, total interest income for the nine months was \$23.6 million. This was comprised of interest earned on our 84 performing loans of \$9.6 million, amortization of purchase discounts and other deferred fees of \$0.6 million and the non-cash amortization of the liquidity discounts on our loans of \$13.4 million. The annualized weighted average interest rate on the loans was 5.10% with a spread to weighted average LIBOR of 4.27% for the nine months ended September 30, 2009. We did not recognize any interest income for the 16 impaired loans with a weighted average loan balance of \$97.8 million that were on non-accrual status during the nine months.

Interest Expense

Interest expense increased \$17.2 million from \$0.3 million for the nine months ended September 30, 2008 to \$17.5 million for the same period in 2009. The increase was due to the acquisition of Cratos and primarily \$17.2 million of interest expense at JMP Credit.

Table of Contents

At JMP Credit, total interest expense for the nine months was \$17.2 million. This was comprised of \$3.4 million in interest on ABS issued, \$13.7 million in non-cash amortization of the liquidity discount on the ABS issued, and \$0.1 million in interest primarily on the contingent consideration to one of the previous owners of Cratos. The annualized weighted average cost of funds for the ABS issued during the nine months ended September 30, 2009 was 1.54% with a spread to weighted average LIBOR of 0.71%.

Provision for Loan Losses

Provision for loan losses increased \$5.0 million from \$0.4 million for the nine months ended September 30, 2008 to \$5.4 million for the same period in 2009. The increase consisted of \$1.4 million against loans held for investment. The remaining \$4.0 million was recorded against loans collateralizing ABS issued at JMP Credit. Of this \$4.0 million, \$3.8 million was additional provision recorded during the second and third quarter of 2009 as specific reserves against impaired loans, in addition to the credit discount recorded against impaired loans at the acquisition date of Cratos to record the impaired loans at their net realizable value. Provision of \$0.2 million was recorded as pooled reserve against performing loans as of September 30, 2009.

Table of Contents**Expenses***Compensation and Benefits*

Compensation and benefits, which includes employee payroll, taxes and benefits, performance-based cash bonus and commissions as well as equity-based compensation to our employees, increased \$26.7 million, or 60.5%, from \$44.1 million for the nine months ended September 30, 2008 to \$70.8 million for the nine months ended September 30, 2009.

Employee payroll, taxes and benefits, and consultant fees, increased \$1.9 million, or 9.3%, from \$20.5 million for the nine months ended September 30, 2008 to \$22.4 million for the nine months ended September 30, 2009 primarily due to the acquisition of Cratos in April 2009 as well as increases in base salaries in May 2008.

Performance-based cash bonus and commissions increased \$27.5 million, or 161.8%, from \$17.0 million for the nine months ended September 30, 2008 to \$44.5 million for the nine months ended September 30, 2009 primarily due to an increase in net revenues after provision for loan losses of \$47.1 million, or 83.5%, from \$56.3 million for the nine months ended September 30, 2008 to \$103.4 million for the nine months ended September 30, 2009. In addition, the Company recorded a performance-based bonus accrual for senior management of \$6.8 million in the quarter ended September 30, 2009.

Equity-based compensation decreased \$2.7 million, or 40.8%, from \$6.6 million for the nine months ended September 30, 2008 to \$3.9 million for the nine months ended September 30, 2009 primarily due the acceleration of the vesting of restricted stock units (RSUs) granted under our 2007 bonus compensation program on December 22, 2008. As a result of the acceleration, the Company recognized \$2.6 million of amortization expense from future periods in the year ended December 31, 2008, thus eliminating the amortization expense on those RSUs that would have been recognized in the future periods, including the nine months ended September 30, 2009. The total equity-based compensation expense for the nine months ended September 30, 2009 and 2008 included \$2.5 million and \$3.0 million, respectively, recognized for RSUs granted in connection with the initial public offering and \$1.4 million and \$3.6 million, respectively, recognized for RSUs granted after the initial public offering.

Compensation and benefits as a percentage of revenues decreased from 78.4% of total net revenues after provision for loan losses for the nine months ended September 30, 2008 to 68.5% for the same period in 2009. This was due to an increase in net interest income, gain on sale and payoff of loans and gain on repurchase of ABS for which we accrue performance-based bonus at a lower rate than other types of revenues. In addition for the nine months ended September 30, 2008 there was the application of our target compensation to revenue ratios to decreased revenues used for the accrual of bonuses, as adjusted by management to maintain competitive compensation levels to employees. This created higher compensation and benefits as a percentage of revenues as compared to the same period for 2009. Excluding expense from RSU s granted in connection with the initial public offering of \$3.0 million and \$2.5 million for the nine months ended September 30, 2008 and 2009, respectively, as a percentage of total net revenues after provision for loan losses, compensation and benefits decreased from 73.0% to 66.1%.

Administration

Administration expenses decreased \$1.1 million, or 23.2%, from \$4.6 million for the nine months ended September 30, 2008 to \$3.5 million for the nine months ended September 30, 2009. The decrease was primarily due to lower conferences expense in the first nine months 2009 compared to the same period in 2008. As a percentage of total revenues, administration expense decreased from 8.2% of total revenues for the nine months ended September 30, 2008 to 3.4% for the same period in 2009 as a result of higher revenues in 2009 compared to 2008.

Brokerage, Clearing and Exchange Fees

Brokerage, clearing and exchange fees increased \$0.2 million, or 5.1%, from \$3.9 million for the nine months ended September 30, 2008 to \$4.1 million for the nine months ended September 30, 2009. This increase is primarily due to higher trading services costs in the nine-month period ended September 30, 2009, compared to the same period in 2008. As a percentage of total net revenues after provision for loan losses, our brokerage, clearing and exchange fees decreased from 6.8% for the nine months ended September 30, 2008 to 3.9% for the same period in 2009.

Other Expenses

Other expenses decreased \$0.5 million, or 5.0%, from \$10.5 million for the nine months ended September 30, 2008 to \$10.0 million for the nine months ended September 30, 2009. The decrease was primarily due to a decrease in travel and business development expense of \$1.2 million, offset by a \$0.4 million increase occupancy and a \$0.4 million increase in CLO administration expense at JMP Credit. As a percentage of total net revenues after provision for loan losses, other expenses decreased from 18.5% for the nine months ended September 30, 2008 to 9.6% for the

Edgar Filing: JMP Group Inc. - Form 10-Q

same period in 2009 mostly as a result of higher revenues in 2009 compared to the same period in 2008.

Edgar Filing: JMP Group Inc. - Form 10-Q

Net Income (Loss) Attributable to Noncontrolling Interest

Net income (loss) attributable to noncontrolling interest increased \$1.4 million from net loss of \$0.2 million for the nine months ended September 30, 2008 to net income of \$1.2 million for the same period in 2009. Noncontrolling interest for the nine months ended September 30, 2009 includes the interest of third parties in JMP Credit Corporation (JMP Credit), Harvest Mortgage Opportunities Partners (HMOP), and Opportunity Acquisition Corp. (SPAC), partially-owned subsidiaries consolidated on our books. Noncontrolling interest for the nine months ended September 30, 2008 relates to the interest of third parties in SPAC, JMP Realty Trust (JMPRT), and in two of our asset management funds, Harvest Consumer Partners (HCP) and Harvest Technology Partners (HTP). Because of the ownership and external management position which did not provide the limited partners with substantive rights to remove the general partner, we consolidated JMPRT, HCP and HTP through December 31, 2008, November 30, 2008 and July 31, 2008, respectively, and recorded noncontrolling interest. Additional limited partners invested in HTP and HCP during 2008 and the limited partners had substantive rights to remove the general partner effective August 1, 2008 for HTP and December 1, 2008 for HCP. As a result, we deconsolidated HTP and HCP as of the respective effective date. The assets and liabilities of JMPRT were transferred to HMOP effective January 2, 2009. Because of the limited partners' substantive kick out rights, HMOP was not required to be consolidated from January 2, 2009 through April 30, 2009. During the quarter ended June 30, 2009, several non-affiliated limited partners redeemed their interest in HMOP, and the remaining limited partners were no longer deemed to have substantive kick-out rights. As a result, the Company consolidated HMOP in its consolidated financial statements effective May 1, 2009.

Table of Contents*Provision for Income Taxes*

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

In connection with our initial public offering and Reorganization, we are subject to federal and state income taxes on all taxable income earned subsequent to May 15, 2007. Additionally, in connection with the Reorganization, we recognized a one-time tax benefit of \$4.0 million in connection with the establishment of net deferred tax asset items of \$10.2 million. In calculating the one-time tax benefit amount and associated deferred tax asset items, the Company made reasonable estimates of its share of the 2006 taxable income and 2007 taxable income attributed to the period from January 1 through May 15, 2007 of the partnerships in which it has a direct or indirect interest.

For the nine months ended September 30, 2009 and 2008, we recorded tax expense of \$6.5 million and tax benefit of \$2.5 million, respectively. The tax benefit for the nine months ended September 30, 2008 included an adjustment of \$0.3 million to the \$4.0 million one-time tax benefit recorded in 2007.

The effective tax rate for the nine months ended September 30, 2009 and 2008 was 43.3% and 38.2%, respectively. Excluding the one-time tax benefit described above, the effective tax rate for the nine months ended September 30, 2008 was 33.3%.

Financial Condition, Liquidity and Capital Resources

In the section that follows, we discuss the significant changes in the components of our balance sheet, cash flows and capital and liquidity for the nine months ended September 30, 2009 to illustrate where our capital is invested and the financial condition of the Company.

Acquisition of Cratos

On April 7, 2009 we invested \$4.0 million of cash and granted \$3.0 million original par amount, with a \$2.3 million estimated fair value, of contingent consideration (a zero coupon note) to acquire 100% of the membership interests and net assets of \$7.5 million of Cratos. As we purchased 100% of the subordinated securities of the Cratos CLO as part of the acquisition, in accordance with the authoritative guidance under GAAP on accounting for consolidation of variable interest entities, we are the primary beneficiary and are required to consolidate all of the assets and liabilities of the CLO securitization structure even though it is a bankruptcy remote entity with no recourse to us.

The table below details the total assets and liabilities consolidated for GAAP upon the acquisition.

| | |
|--|-----------------------|
| Assets: | |
| Cash and cash equivalents | \$ 1,910,523 |
| Restricted cash and deposits | 44,359,080 |
| Loans collateralizing asset-backed securities issued | 280,499,632 |
| Interest receivable | 1,136,896 |
| Deferred tax asset | 50,121,928 |
| Other assets | 254,387 |
| Total assets | \$ 378,282,446 |
| Liabilities: | |
| Asset-backed securities issued | \$ 316,513,000 |
| Interest payable | 1,209,588 |
| Other liabilities | 2,349,830 |
| Deferred tax liability | 50,703,100 |
| Total liabilities | \$ 370,775,518 |

Edgar Filing: JMP Group Inc. - Form 10-Q

| | |
|------------------------------------|--------------|
| Net assets acquired, at fair value | \$ 7,506,928 |
|------------------------------------|--------------|

The CLO securitization entity is non-recourse to us. Our maximum loss of capital as of September 30, 2009 is the original April 7, 2009 investment of \$4.0 million plus any earnings related to JMP Credit since the acquisition date. The contingent consideration is only payable from the first \$3.0 million of cash flows to the CLO subordinated securities we hold. If those securities do not receive cash flows, then we are not liable to make payments to the recipient of the contingent consideration. However, for US Federal tax purposes, the CLO is treated as a disregarded entity such that the taxable income earned in the CLO is taxable to us. If the CLO is in violation of certain coverage tests, mainly any of its overcollateralization ratios, residual cash flows otherwise payable to us as owners of the subordinated notes would be required to be used to buy additional collateral or repay indebtedness senior to us in the securitization. This could require us to pay income tax on earnings not distributed to us.

Table of Contents

The CLO market in which we invest has experienced an increase in downgrades, defaults and declines in market value in respect of leveraged loans in their collateral. The CLO has to comply with certain asset coverage tests, such as the amount of discounted obligations and CCC obligations it can hold. During any time the CLO exceeds such a limit, the ability of us, as CLO manager, to sell assets and reinvest available principal proceeds into substitute assets is restricted. In addition, defaulted obligations, discounted assets (those purchased below 85% of their par value) and assets rated CCC or lower in excess of applicable limits in the CLO's investment criteria are not given full par credit for purposes of calculation of the CLO overcollateralization (OC) tests. As a result, many CLOs are failing or may in the future fail one or more of their overcollateralization tests. If this were to occur for our CLO, it could cause a diversion of cash flows away from us as holders of the more junior CLO securities in favor of investors more senior than us in right of repayment, until the relevant overcollateralization tests are satisfied. In August 2009, our CLO was in violation of the Class E OC test. As such, we were required to use \$3.7 million of the residual cash flows to pay down Class A note holders rather than distribute the money to us as owners of the subordinated notes. If the CLO continues to violate the Class E test, or any more senior tests, we will continue paying down the most senior notes with the residual cash flows until the violation was cured. In the most extreme case, if the CLO were in violation of the most senior OC test, the Class A note holders would have the ability to declare an event of default and cause an acceleration all principal and interest outstanding on the notes.

For financial reporting purposes, the loans and asset backed securities are consolidated and reported at their cost adjusted for amortization of liquidity discount which was recorded at the Cratos acquisition date. At September 30, 2009 there was \$317.2 million of loans, \$28.5 million of cash and \$1.7 million of other assets owned by the CLO funded by \$322.8 million of asset-backed securities issued. These assets and asset-backed securities issued represented 56.7% of total assets and 73.3% of total liabilities respectively, reported on our consolidated statement of financial condition at September 30, 2009.

Other Factors Affecting Our Liquidity and Capital Resources

The timing of bonus compensation payments to our employees may significantly affect our cash position and liquidity from period to period. While our employees and managing directors are generally paid semi-monthly during the year, bonus compensation, which makes up a larger portion of total compensation, is generally paid once a year during the first two months of the following year. In February 2009, we paid out \$18.9 million of cash bonuses for 2008, excluding employer payroll tax expense.

In February 2009, the Company made a \$2.0 million investment in HuaMei Capital Company, Inc. (HuaMei), a joint venture with China Merchants Securities Co. (HK), Ltd., a securities brokerage and investment banking firm, and other private investors. Through HuaMei, the Company can provide investment banking services to U.S. and Chinese companies seeking to execute cross-border transactions on both sides of the Pacific.

As of September 30, 2009, we had net liquid assets of \$71.4 million, consisting of cash and cash equivalents, proceeds from short sales on deposit, receivable from clearing broker, marketable securities owned, and general partner investments in hedge funds managed by HCS, net of marketable securities sold but not yet purchased, accrued compensation, note payable and noncontrolling interest. We had an undrawn \$18.9 million and \$21.0 million revolving line of credit with City National Bank (the Lender) at September 30, 2009 and December 31, 2008, respectively. During the nine months ended September 30, 2009, we drew down \$2.1 million on the revolving line of credit to fund the HuaMei investment and \$4.0 million to fund the purchase of Cratos. The \$4.0 million drawn down to fund the purchase of Cratos was repaid during the same period.

Most of our financial instruments, other than loans collateralizing asset-backed securities issued, loans held for investment and asset-backed securities issued, are recorded at fair value or amounts that approximate fair value. At September 30, 2009 and December 31, 2008, the Company had Level 3 assets (assets whose fair value was determined using unobservable inputs that are not corroborated by market data) of \$25.2 million and \$18.2 million which represented 4.5% and 11.9% of total assets, respectively. The decrease in the percentage of Level 3 assets to the total assets was primarily due to an increase in total assets from \$152.8 million at December 31, 2008 to \$560.0 million at September 30, 2009 mainly due to the acquisition of Cratos in April 2009. During the quarter ended September 30, 2009, we reclassified our limited partner investment in a mortgage fund of \$2.0 million from Level 2 to Level 3, as the fund further invested in residential mortgage loans during the quarter.

Edgar Filing: JMP Group Inc. - Form 10-Q

A condensed table of cash flows for the three months ended September 30, 2009 and 2008 is presented below.

| (in thousands) | Nine Months Ended September 30, | | Change from | |
|---|---------------------------------|--------------------|------------------|---------------|
| | 2009 | 2008 | 2008 to 2009 | 2008 to 2009 |
| | \$ | \$ | \$ | % |
| Cash flows provided by (used in) operations | \$ 9,635 | \$ (24,575) | \$ 34,210 | 139.2% |
| Cash flows provided by (used in) investing activities | 2,751 | (26,809) | 29,560 | 110.3% |
| Cash flows provided by (used in) financing activities | (3,440) | 2,208 | (5,648) | N/A |
| Total cash flows | \$ 8,946 | \$ (49,176) | \$ 58,122 | 118.2% |

JMP Securities, our wholly-owned subsidiary and a registered securities broker-dealer, is subject to the net capital requirements of the SEC's Uniform Net Capital Rule. We use the basic method permitted by the Uniform Net Capital Rule to compute net capital, which generally requires that the ratio of aggregate indebtedness to net capital shall not exceed 15 to 1. SEC regulations also provide that equity capital may not be withdrawn or cash dividends paid if certain minimum net capital requirements are not met. JMP Securities had net capital of \$31.7 million and \$39.8 million, which were \$30.2 million and \$38.7 million in excess of the required net capital of \$1.5 million and \$1.1 million at September 30, 2009 and December 31, 2008, respectively. JMP Securities' ratio of aggregate indebtedness to net capital was 0.41 to 1 and 0.24 to 1 at September 30, 2009 and December 31, 2008, respectively.

Table of Contents

The Company currently intends to declare quarterly cash dividends on all outstanding shares of common stock. The Company currently does not plan to pay dividends on unvested shares of restricted stock. In March, May and August 2009, the Company's board of directors declared a quarterly cash dividend of \$0.01 per share of common stock which the Company paid in April, June and September 2009, for the fourth quarter of 2008 and the first and second quarter of 2009, respectively.

On March 3, 2009, the Company's board of directors authorized the repurchase of an additional 0.5 million shares of our common stock during the next twelve months, depending on market conditions.

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

Cash Flows for the Nine Months Ended September 30, 2009

Cash decreased by \$8.9 million during the nine months ended September 30, 2009, primarily as a result of cash used in investing activities.

Our operating activities provided \$9.6 million of cash from the net income of \$8.5 million adjusted for the cash provided by the change in operating assets and liabilities of \$14.5 million, reduced by non-cash revenue and expense items of \$13.4 million. The non-cash revenue and expense items included gains on sale and payoff of loans of \$11.6 million, gain on repurchase of asset-backed securities issued of \$4.2 million, gain on bargain purchase of \$1.2 million and provision for loan losses of \$5.4 million.

Our investing activities provided \$2.8 million, which primarily due to cash provided by sales of loans collateralizing ABS of \$46.2 million, repayments on loans collateralizing ABS of \$32.0 million, net change in restricted cash reserved for lending activities of \$14.7 million, and sales of other investments of \$12.3 million, offset by cash used in funding of loans collateralizing ABS of \$93.6 million and purchases of other investments of \$7.5 million.

Our financing activities used \$3.4 million of cash primarily due to two draw downs on our revolving note with City National Bank (CNB) totaling \$6.1 million, offset by repayments of note payable on a term loan of \$1.0 million, repayment of one of the draw downs of \$4.0 million and net increase in ABS of \$3.2 million.

We had \$28.5 million of restricted cash at JMP Credit on September 30, 2009. This balance was comprised of \$3.1 million in interest and fees received from loans in the CLO and \$25.4 million in principal cash. The interest and fees will be restricted until the next payment date to note holders of the CLO. The principal restricted cash will be used to buy additional loans or pay down CLO notes.

Cash Flows for the Nine Months Ended September 30, 2008

Cash decreased by \$49.2 million during the nine months ended September 30, 2008, primarily as a result of cash used in operating and investing activities.

Our operating activities used \$24.6 million of cash from the net loss of \$4.2 million, adjusted for the cash used in the change in operating assets and liabilities of \$22.2 million and non-cash revenue and expense items of \$1.8 million. The decrease in operating assets and liabilities was primarily due to the payout of \$26.9 million in 2007 bonuses in February 2008.

Our investing activities used \$26.8 million, which consisted mostly of \$14.5 million of net purchases of other investments, the funding of \$8.0 million in loans receivable and \$4.7 million in cash attributable to the deconsolidation of an investment. During the nine months of 2008, we invested \$15.0 million in Series A Cumulative Redeemable Convertible Preferred stock of NYMT, as well as \$4.5 million in NYMT common stock as part of the PIPE transaction executed by NYMT on February 18, 2008.

Our financing activities provided \$2.2 million of cash primarily due to a draw down on our revolving note with City National Bank and capital contributions from minority members in the nine months of 2008, offset by our cash dividends paid to shareholders and our repurchases of our common shares for treasury.

Contractual Obligations

Our contractual obligations have not materially changed from those reported in our Annual Report on Form 10-K for the year ended December 31, 2008.

Off-Balance Sheet Arrangements

In connection with the Cratos CLO, the Company had unfunded commitments to lend of \$3.6 million and standby letters of credit of \$1.7 million.

Unfunded commitments are agreements to lend to a borrower, provided that all conditions have been met. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since certain commitments may expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Company evaluates each borrower's creditworthiness on a case by case basis.

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance by a borrower to a third party. The Company's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for standby letters of credit is represented by the contractual amount of those instruments. The Company uses the same credit policies in making commitments and conditional obligations as it does for on balance sheet instruments. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loans to borrowers.

We had no other material off-balance sheet arrangements as of September 30, 2009. However, as described below under *Qualitative and Quantitative Disclosures About Market Risk - Credit Risk*, through indemnification provisions in our clearing agreements with our clearing broker, customer activities may expose us to off-balance sheet credit risk, which we seek to mitigate through customer screening and collateral requirements.

Qualitative and Quantitative Disclosures About Market Risk

Market Risk

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

Table of Contents

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

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

Equity Price Risk

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

Interest Rate Risk

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

Credit Risk

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

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

Credit risk also includes the risk that we will not fully collect the principal we have invested in loans held for investment and loans collateralizing asset-backed securities issued due to borrower defaults. While we feel that our origination and underwriting of these loans will help to mitigate the risk of significant borrower defaults on these loans, we cannot assure you that all borrowers will continue to satisfy their payment obligations under these loans, thereby avoiding default.

Inflation Risk

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

Critical Accounting Policies and Estimates

The preparation of our consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and of revenues and expenses during the reporting periods. We base our estimates and assumptions on historical experience and on various other factors that we believe are reasonable under the circumstances. The use of different estimates and assumptions could

Edgar Filing: JMP Group Inc. - Form 10-Q

produce materially different results. For example, if factors such as those described in Risk Factors cause actual events to differ from the assumptions we used in applying the accounting policies, our results of operations, financial condition and liquidity could be adversely affected.

Edgar Filing: JMP Group Inc. - Form 10-Q

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

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

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

Table of Contents

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

Valuation of Financial Instruments

The Company adopted the amended accounting principles related to fair value measurements as of January 1, 2008 which establishes a consistent framework for measuring fair value in accordance with generally accepted accounting principles and expands disclosures with respect to fair value measurements. The amended accounting principles related to fair value measurement apply to all financial instruments that are being measured and reported on a fair value basis. This includes those items currently reported in marketable securities owned, at fair value, other investments and marketable securities sold, not yet purchased, at fair value on the consolidated statements of financial condition. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Most of our financial instruments, other than loans collateralizing asset-backed securities issued, loans held for investment and asset-backed securities issued, are recorded at fair value or amounts that approximate fair value. Marketable securities owned, Other investments, including warrant positions and investments in partnerships in which HCS is the general partner, and Marketable securities sold, but not yet purchased, are stated at fair value, with related changes in unrealized appreciation or depreciation reflected in the line item Principal transactions in the accompanying Consolidated Statements of Operations.

Fair value our financial instruments is generally obtained from quoted market prices, broker or dealer price quotations, or alternative pricing methodologies that we believe offer reasonable levels of price transparency. To the extent that certain financial instruments trade infrequently or are non-marketable securities and, therefore, do not have readily determinable fair values, we estimate the fair value of these instruments using various pricing models and the information available to us that we deem most relevant. Among the factors considered by us in determining the fair value of financial instruments are discounted anticipated cash flows, the cost, terms and liquidity of the instrument, the financial condition, operating results and credit ratings of the issuer or underlying company, the quoted market price of publicly traded securities with similar duration and yield, the Black-Scholes Options Valuation methodology adjusted for active market and other considerations on a case-by-case basis and other factors generally pertinent to the valuation of financial instruments.

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

Also included in other investments are NYMT convertible preferred stock and warrants on public and private common stock. The valuation of the investment in NYMT convertible preferred stock is based on a fair value estimate using the Black-Scholes credit adjusted valuation model on Bloomberg. The warrants on public and private common stock are generally received as a result of investment banking transactions and are valued at estimated fair value as determined by management. Warrants owned are valued at the date of issuance and marked-to-market as unrealized gains and losses until realized. Estimated fair value is determined using the Black-Scholes Options Valuation methodology adjusted for active market and other considerations on a case-by-case basis.

The Company follows the authoritative guidance included in GAAP on the fair value option which provides companies with an option to report selected financial assets and financial liabilities at fair value. It requires entities to display the fair value of those assets and liabilities for which the company has chosen to use fair value on the face of the balance sheet. The election to use the fair value option is available at specified election dates, such as when an entity first recognizes a financial asset or financial liability or upon entering into a firm commitment. Subsequent changes in fair value must be recorded in the Consolidated Statements of Operations. Additionally, the guidance allows for a one-time election for existing positions upon adoption, with the transition adjustment recorded to beginning retained earnings.

We elected to apply the fair value option to the following financial assets:

Edgar Filing: JMP Group Inc. - Form 10-Q

Investment in NYMT convertible preferred stock; and

Investment in NYMT common stock

During the quarter ended September 30, 2009, the Company recorded unrealized gain of \$2.3 million on the above investments in NYMT primarily in response to the improved performance of NYMT's stock during the period.

In certain cases, we may continue to apply the equity method of accounting to those investments which are strategic in nature or are closely related to our principal business activities, where we have a significant degree of involvement in the cash flows or operations of the investee.

Asset Management Investment Partnerships

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

Table of Contents

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

We are also entitled to receive incentive fee allocations from the investment partnerships when the return exceeds a specified highwater mark or hurdle rate over a defined performance period. Incentive fees are recorded after the quarterly or annual investment performance period is complete and may vary depending on the terms of the fee structure applicable to an investor.

Loans Collateralizing Asset-backed Securities Issued

Loans collateralizing asset-backed securities issued are commercial loans securitized and owned at the Cratos CLO. The loans consist of those loans within the CLO securitization structure at the acquisition date of Cratos and loans purchased or originated into the CLO subsequent to the Cratos acquisition date.

Loans acquired during the purchase and resulting consolidation of Cratos were recorded at their fair value as of the acquisition date, which then became the new basis of the loans. Any unamortized deferred fees or costs that existed prior to the acquisition were written off at that date.

For those loans deemed impaired as of the date of the acquisition, the total discount from unpaid principal balance to fair value consists of a nonaccretable credit discount and an accretable liquidity (or market value) discount. For the remaining loans acquired through the purchase of Cratos the discount to fair value was all accretable liquidity discount as the discount was not attributable to credit quality. For both types of loans the accretable portion of the discount is recognized into interest income as an adjustment to the yield of the loan over the contractual life of the loan using the interest method.

The Company continues to estimate the cash flows expected to be collected over the life of the loans acquired through the purchase of Cratos. If, upon subsequent evaluation, the Company believes it is unable to collect all cash flows expected at the acquisition date plus additional cash flows expected to be collected arising from changes in estimate after the acquisition, the loan is considered impaired for purposes of applying the authoritative guidance under GAAP on loss contingencies or, if applicable, the authoritative guidance under GAAP on loan impairment. Loans considered impaired at the acquisition date of Cratos can only continue to be assessed in accordance with the authoritative guidance under GAAP on loan impairment. If based on current information and events, it is probable that there is a significant increase in cash flows previously expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, the Company will first reduce any remaining valuation allowance (or allowance for loan losses) for the loan established after its acquisition for the increase in the present value of cash flows expected to be collected. Then the Company will recalculate the amount of accretable yield for the loan as the excess of the revised cash flows expected to be collected over the sum of (a) the initial investment less (b) cash collected less (c) write-downs plus (d) amount of yield accreted to date. The Company will adjust the amount of accretable yield by reclassification from nonaccretable discount. The adjustment is accounted for as a change in estimate, with the amount of periodic accretion adjusted over the remaining life of the loan. The resulting yield is then used as the effective interest rate in any subsequent accounting.

Loans purchased or originated into the CLO after the acquisition date of Cratos, are stated at the principal amount outstanding net of deferred fees, deferred costs and the allowance for loan losses. Net nonrefundable loan fees and related direct costs associated with the origination or purchase of loans are deferred and included in loans. The net deferred fees or costs are recognized as an adjustment to interest income over the contractual life of the loans using a method which approximates the interest method. Remaining amounts are recognized into income when the related loans are paid off or sold. Any discount from purchased loans is accreted into interest income as a yield adjustment over the contractual life of the loan.

The accrual of interest on loans is discontinued when principal or interest payments are 90 days or more past due or when, in the opinion of management, reasonable doubt exists as to the full collection of principal and/or interest. When loans are placed on nonaccrual status, all interest previously accrued but not collected is reversed against current period interest income. Any reversals of income from previous years are recorded against the allowance for loan losses. When the Company receives a cash interest payment on a non-accrual loan, it is applied as a reduction of the principal balance. Non-accrual loans are returned to accrual status when the borrower becomes current as to principal and interest and have demonstrated a sustained period of payment performance. The amortization of loan fees is discontinued on nonaccrual loans and may be considered for write-off. Depending on the terms of the loan, a fee may be charged upon a prepayment which is recognized in the period of the prepayment. Syndication and structuring fees are recognized in the period the service is completed as non-interest income.

Allowance for Loan Losses

The Company maintains an allowance for loan losses that is intended to estimate loan losses inherent in its loan portfolio. A provision for loan losses is charged to expense to establish the allowance for loan losses. The allowance for loan losses is maintained at a level, in the opinion of management, sufficient to off set estimated losses inherent in the loan portfolio as of the date of the financial statements. The appropriateness of the allowance and the allowance components are reviewed quarterly. The Company's estimate of each allowance component is based on observable information and on market and third party data that the Company believes are reflective of the underlying loan losses being estimated.

In accordance with the authoritative guidance under GAAP on loss contingencies, the Company provides a base allowance on a loan by loan basis for loans at JMP Credit that are not impaired and were purchased after the Cratos acquisition. The Company employs internally developed and third party estimation tools for measuring credit risk (loan ratings, probability of default, and exposure at default), which are used in developing an appropriate allowance for loan losses. The Company performs periodic detailed reviews of its loan portfolio to identify risks and to assess the overall collectibility of loans.

Table of Contents

In accordance with the authoritative guidance under GAAP on loan impairment, any required impairment allowances are included in the allowance for loan losses. A loan is considered impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. The Company measures impairment of a loan based upon either the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or the fair value of the collateral securing the loan if the loan is collateral dependent, depending on the circumstances and the Company's collection strategy. For those loans held by Cratos at the date of acquisition by JMP Credit, and deemed impaired at that date or a subsequent date, loan loss provisions are calculated considering two further factors. For loans deemed impaired at the date of acquisition if there is a further decline in expected future cash flows, this reduction is recognized as specific loan loss provision in the current quarter in accordance with above. For those loans deemed impaired subsequent to the acquisition date, if the net realizable value is lower than the current carrying value then that reduction from the carrying value is booked as provision for loan losses. Therefore at the date of assessment, if the total discount from unpaid principal balance to carrying value is larger than the expected loss, no provision for loan losses is recognized for those loans acquired at Cratos but deemed impaired subsequent to their acquisition.

Loans which are deemed to be uncollectible are charged off and deducted from the allowance. The provision for loan losses and recoveries on loans previously charged off are added to the allowance.

Asset-backed Securities Issued

Asset-backed securities issued (ABS) were issued to third parties from the Cratos CLO securitization structure which the Company consolidates for financial reporting purposes as of the April 7, 2009 acquisition date. At the acquisition date, the ABS were recorded at fair value with a liquidity discount from the principal balance outstanding to the fair value recorded. The liquidity discount is amortized into interest expense over the maturity of the ABS using the interest method.

Legal and Other Contingent Liabilities

We are involved in various pending and potential complaints, arbitrations, legal actions, investigations and proceedings related to our business from time to time. Some of these matters involve claims for substantial amounts, including claims for punitive and other special damages. The number of complaints, legal actions, investigations and regulatory proceedings against financial institutions like us has been increasing in recent years. We have, after consultation with counsel and consideration of facts currently known by management, recorded estimated losses in accordance with SFAS 5 (ASC 450-10), *Accounting for Contingencies*, to the extent that a claim may result in a probable loss and the amount of the loss can be reasonably estimated. The determination of these reserve amounts requires significant judgment on the part of management and our ultimate liabilities may be materially different. In making these determinations, management considers many factors, including, but not limited to, the loss and damages sought by the plaintiff or claimant, the basis and validity of the claim, the likelihood of successful defense against the claim and the potential for, and magnitude of, damages or settlements from such pending and potential complaints, legal actions, arbitrations, investigations and proceedings, and fines and penalties or orders from regulatory agencies.

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

Income Taxes

The Company accounts for income taxes in accordance with the authoritative guidance under GAAP on income taxes which requires the recognition of deferred tax assets and liabilities based upon the temporary differences between the financial reporting and tax bases of assets and liabilities. Valuation allowances are established when necessary to reduce the deferred tax assets when it is more likely than not that a portion or all of the deferred tax assets will not be realized. The Predecessor, JMP Group LLC, was a limited liability company and was treated as a partnership for federal and state income tax purposes. Therefore, the Predecessor was not subject to federal and state income taxes, and accordingly, did not provide for the federal and state income taxes in the financial statements, but it was liable for state and local unincorporated business tax or franchise tax.

The Company adopted the accounting principles related to uncertainty in income taxes on May 16, 2007, the date the Company became subject to federal and state income taxes. Its adoption did not have a material impact on the Company's financial condition or results of operations. Under the guidance, the Company recognizes a tax benefit from an uncertain position only if it is more likely than not that the position is sustainable, based solely on its technical merits and consideration of the relevant taxing authority's widely understood administrative practices and precedents. If this threshold is met, the Company measures the tax benefit as the largest amount of benefit that is greater than fifty percent likely of being realized upon ultimate settlement.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

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

ITEM 4. Controls and Procedures

Our management, with the participation of the Chairman and Chief Executive Officer and the Chief Financial Officer, has evaluated our disclosure controls and procedures as of the end of the period covered by this report. Our evaluation included disclosure controls and procedures applicable to Cratos. Based on that evaluation, our Chairman and Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Securities Exchange Act of 1934, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the Chairman and Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In connection with our acquisition of Cratos, as of September 30, 2009, we have completed the process of integrating the financial reporting process of Cratos into our financial reporting process. Accordingly, we have implemented the appropriate internal control over financial reporting at Cratos to ensure our overall disclosure controls and procedures are effective. Other than the completion of integrating the financial reporting process of Cratos, there was no change in our internal control over financial reporting that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents**PART II OTHER INFORMATION****ITEM 1. Legal Proceedings**

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

We review the need for any loss contingency reserves and establish reserves when, in the opinion of management, it is probable that a matter would result in liability and the amount of loss, if any, can be reasonably estimated. Generally, with respect to matters we are involved in, in view of the inherent difficulty of predicting the outcome of these matters, particularly in cases in which claimants seek substantial or indeterminate damages, it is not possible to determine whether a liability has been incurred or to reasonably estimate the ultimate or minimum amount of that liability until the case is close to resolution, in which case no reserve is established until that time.

ITEM 1A. Risk Factors

The risk factors included in our December 31, 2008 annual report on Form 10-K continue to apply to us, and describe risks and uncertainties that could cause actual results to differ materially from the results expressed or implied by the forward-looking statements contained in this Quarterly Report. There have not been any material changes from the risk factors previously described in our December 31, 2008 annual report on Form 10-K except for the addition of the following risk factor:

The recent crisis in the global credit markets has the potential to adversely affect our CLO investments.

The global economy has been affected by a crisis in the credit markets and has experienced a general downturn. Among the sectors particularly challenged by the current crisis in the global credit markets are the CLO and leveraged finance markets. In the current environment, liquidity in the credit markets has been reduced, resulting in an increase in credit spreads and a decline in ratings, performance and market values for leveraged loans. We have significant exposure to these markets through our investments in Cratos CLO I, a Cayman Islands incorporated special purpose company that issued notes to investors secured by a pool of corporate loans. We invested in deeply subordinated securities issued by the CLO, representing highly leveraged investments in the underlying collateral, which increases both the opportunity for higher returns as well as the magnitude of losses when compared to the other investors that rank more senior to us in right of payment. As a result of our subordinated position in the CLO, we and our investors are at greater risk of suffering losses.

The corporate loan market in which our CLO invests has experienced an increase in downgrades, defaults and declines in market value in respect of their collateral. The CLO portfolio profile tests set limits on the amount of discounted obligations it can hold. During any time that it exceeds such a limit, the ability of the CLO's manager to sell assets and reinvest available principal proceeds into substitute assets is restricted. In addition, discounted assets and assets rated CCC or lower in excess of applicable limits in the CLO issuers' investment criteria are not given full par credit for purposes of calculation of the CLO issuers' overcollateralization tests. As a result, many CLO issuers are failing or may in the future fail one or more of their overcollateralization tests. This has occurred for our CLO and caused a diversion of cash flows away from us as holders of the more junior CLO securities in favor of investors more senior than us in right of repayment. Until the relevant overcollateralization tests are satisfied, we will continue to see the residual cash flows diverted away from us. This diversion of cash flows could have an adverse impact on our business and our ability to make distributions to shareholders. In addition, it is possible that the Cratos CLO I's collateral will be depleted before we realize a return on our CLO investments.

The ability of the Cratos CLO I to make interest payments to the holders of its senior notes is highly dependent upon the performance of the CLO collateral. If the collateral was to experience a significant decrease in cash flow due to an increased default level, the issuer may be unable to pay interest to the holders of the senior notes which would allow such holders to declare an event of default under the indenture governing the transaction and accelerate all principal and interest outstanding on the senior notes. In addition, the indenture governing our CLO also contains certain events of default tied to the value of our collateral which could cause an acceleration of the senior notes. If the value of the CLO collateral within the CLO were to be less than 102% of the amount of most senior class of notes issued and outstanding, the most senior noteholders would have the ability to declare an event of default.

Edgar Filing: JMP Group Inc. - Form 10-Q

There can be no assurance that market conditions giving rise to these types of consequences will not occur, subsist or become more acute in the future.

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

The table below sets forth the information with respect to purchases made by or on behalf of JMP Group Inc. or any affiliated purchaser (as defined in Rule 10b-18(a)(3) under the Securities Exchange Act of 1934), of our common stock during the quarter ended September 30, 2009.

| Period | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|---|----------------------------------|------------------------------|--|--|
| July 1, 2009 to July 31, 2009 | | \$ | | 1,213,718 |
| August 1, 2009 to August 31, 2009 | 324(2) | \$ 6.40 | 324 | 1,213,394 |
| September 1, 2009 to September 30, 2009 | | \$ | | 1,213,394 |
| Total | 324 | | 324 | |

- (1) A 1.5 million share repurchase program authorized in August and November 2007 was fully executed as of January 18, 2008. On March 10, 2008 and March 3, 2009, the Company's board of directors authorized the repurchase of an additional 2.0 million shares during the subsequent eighteen months and the repurchase of an additional 0.5 million shares during the subsequent twelve months, respectively.
- (2) Consist of 324 shares repurchased in connection with employee stock plans, whereby the Company's shares were tendered by employees for the payment of applicable withholding taxes.

ITEM 3. Defaults Upon Senior Securities

None.

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

None.

ITEM 5. Other Information

None.

ITEM 6. Exhibits

See Exhibit Index.

Table of Contents

SIGNATURES

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

Date: November 4, 2009

JMP Group Inc.

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

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

Table of Contents

EXHIBIT INDEX

Exhibit

| Number | Description |
|---------------|---|
| 31.1 | Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |