

JMP Group Inc.  
Form 10-K  
March 13, 2014

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-K**

(Mark One)

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

For the fiscal year ended December 31, 2013

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)

Delaware  
(State or other jurisdiction of incorporation or organization) 20-1450327  
(I.R.S. Employer Identification No.)

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

**(Address of principal executive offices)**

**Registrant's telephone number, including area code: (415) 835-8900**

**Securities registered pursuant to Section 12(b) of the Act:**

| <b><u>Title of Each Class</u></b>                | <b><u>Name of Each Exchange on Which Registered</u></b> |
|--|---|
| <b>Common Stock, par value \$0.001 per share</b> | <b>New York Stock Exchange</b>                          |
| <b>7.25% Senior Notes due 2021</b>               | <b>New York Stock Exchange</b>                          |
| <b>8.00% Senior Notes due 2023</b>               | <b>New York Stock Exchange</b>                          |

**Securities registered pursuant to Section 12(g) of the Act:**

**None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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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      Smaller Reporting Company

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

The aggregate market value of the voting and non-voting common stock held by non-affiliates of the registrant on the last business day of the registrant’s most recently completed second fiscal quarter, based upon the closing sale price of the registrant’s common stock on June 30, 2013 as reported on The New York Stock Exchange was \$104,085,021.

As of February 28, 2014 there were 21,821,152 shares of the registrant’s common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant’s definitive proxy statement to be delivered to stockholders in connection with the 2014 annual meeting of stockholders to be held in June 2014 are incorporated by reference in this Form 10-K. Such proxy statement will be filed with the U.S. Securities and Exchange Commission (the “SEC”) within 120 days of the registrant’s fiscal year ended December 31, 2013.

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## SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

We make forward-looking statements, as defined by the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, in this Form 10-K that are subject to risks and uncertainties. When we use the words “could,” “will likely result,” “if,” “in the event,” “may,” “might,” “should,” “shall,” “will,” “believe,” “expect,” “anticipate,” “plan,” “predict,” “project,” “intend,” “estimate,” “goal,” “objective,” “continue,” or the negatives of these terms and other similar expressions, we intend to identify forward-looking statements. These forward-looking statements include information about possible or assumed future results of our business, financial condition, liquidity, results of operations, plans and objectives. They also include statements concerning anticipated revenues, income or loss, capital expenditures, dividends, capital structure or other financial terms. The statements we make regarding the following subject matters are forward-looking by their nature:

- the opportunity to grow our investment banking and sales and trading businesses because of the prevalent demand for our services in our four target industries;
- the opportunity to increase our representation of corporate clients as buyers and to grow our mergers and acquisitions and strategic advisory businesses;
- our belief that market conditions in the specialty financial services and real estate industries may work to our advantage if we are able to leverage our expertise to gain new business;
- the performance of our investment banking and sales and trading businesses because of declining demand for our services or a decline in the market for securities of companies in our four target industries;
- the possibility of generating stable or growing investment banking revenues due to our ability to engage in multiple types of transactions;
- our ability to succeed as a strategic advisor due to our ability to structure and execute complex transactions;
- the growth of our mergers and acquisitions and other strategic advisory business derived from our positions as a lead manager or senior co-manager of public and private securities offerings;
- our plans to continue to provide our equity research and sales and trading products and services to small and middle-market companies to benefit institutional investors;
- the characteristics of the asset management business, including its comparatively high margins, the recurring nature of its fee-based revenues, and its dependence on intellectual capital and our belief that this makes the asset

management business less susceptible to competitive threats from larger financial institutions;

- a heightened demand for alternative asset management products and services;
- our ability to increase assets under management and develop new asset management products;
- our plans to generate principal investing opportunities from our investment banking and asset management relationships;
- our ability to attract, incentivize and retain top professionals and to retain valuable relationships with our clients;
- plans to grow our businesses both through internal expansion and through strategic investments, acquisitions, or joint ventures;
- our expectations regarding the impact of the trend toward alternative trading systems and downward pricing pressure in the sales and trading business on trading commissions and spreads;
- the nature of the competition faced in the investment banking and financial services industries and our expectations regarding trends and changes with respect to competing entities;
- our belief that continued future growth will require implementation of enhanced communications and information systems and the training of personnel or the hiring of an outsourced provider to operate such systems;
- the impact of changes in interest rates on the value of interest-bearing assets in which we invest;
- our plans for the use of the principal restricted cash at JMP Credit Corporation (“JMP Credit”) to buy additional loans or pay down collateralized loan obligation (“CLO”) notes;
- that the past performance of our funds are not indicative of our future performance;
- the emergence of investment opportunities that offer attractive risk-adjustment returns on our investable assets;
  - our ability to take advantage of market opportunities as they arise in 2014 based on the strength of our capital position and the low level of leverage that we have traditionally employed in our business model;





- our ability to satisfy our funding needs with existing internal and external financial sources;
- the ability of our funds to raise capital in the long and short term;
- our ability to depend on follow-on offerings, PIPEs and registered direct offerings to generate corporate finance revenues;
- our ability to realize revenues through gain on sale and payoff of loans and gain on repurchase of asset-backed securities;
- our ability to avoid restrictions imposed by the Investment Company Act of 1940;
- that we do not anticipate any tax adjustments that will result in a material adverse affect on the our financial condition;
- the impact of bonus compensation payments to our employees on our cash position;
- the potential for unfunded commitments to expire and their impact on future cash requirements;
- the impact of additional rulemaking by the SEC with respect to soft dollar practices on our brokerage or asset management business;
- our expectations regarding the likelihood of increased scrutiny of financial services firms from regulators;
- the impact of recent pronouncements by the Financial Accounting Standards Board (the “FASB“) on our financial position or operations;
- the impact of existing claims and currently known threats against us on our business or financial condition;
- our intention to declare dividends, our ability to do so without borrowing funds and our expected dividend rate; and
- that we believe that our available liquidity and current level of equity capital will be adequate to meet our liquidity and regulatory capital requirements for the next twelve months.

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The forward-looking statements are based on our beliefs, assumptions and expectations of future performance, taking into account the information currently available to us. These forward-looking statements 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 upon our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from the results, level of activity, performance or achievements expressed or implied by the forward-looking statements. In particular, you should consider the numerous risks provided under Item 1A—"Risk Factors" in this Form 10-K, including but not limited to the following factors:

- the impact of multiple book runners, co-managers and multiple financial advisors on our revenues;
  - our ability to remain competitive against larger investment banks that provide commercial financing;
  - the impact of conditions in the global financial markets, such as the level and volatility of interest rates, investor sentiment, the availability and the cost of credit, the U.S. mortgage market, the U.S. real estate market, volatile energy prices, consumer confidence, unemployment, and geopolitical issues on our business and revenues;
  - the potential for volatility and weakness in the equity markets to adversely impact our sales and trading business, investment banking business, and ability to manage exposure to market risks;
- the impact of worsening market conditions on our ability to serve as underwriter or placement agent;
- the potential for uncertainty related to creditworthiness, volatility in the equity markets, and diminished access to financing to impact our merger, acquisition and advisory services;
- our expectations regarding the effect of a market downturn on transaction volume, and therefore, our revenues;
- the impact of securities related write-downs on our securities trading revenues;
- the impact of the inability of companies to repay their borrowings on our principal investments;
  - our expectations regarding the impact of bankruptcies on our investment banking revenues;
- the impact of a market downturn on management fees;

- the potential for market declines to lead to an increase in litigation and arbitration claims;

- our ability to pursue business opportunities in an environment of increased legislative or regulatory initiatives;
- the potential effect of governmental fiscal and monetary policy to have a negative impact on our business;
- the impact of any deterioration in the business environment of our target sectors on our revenues;
- our expectation that the ability to recruit and retain professionals impacts our reputation, business, results of operations and financial condition;
- the impact of larger firms on our ability to grow our business;
- the impact of increased competition in the middle-market investment banking space on our market share and revenues;
- the possibility of market and non-market factors to impact our stock price;
- fluctuations in our stock price related to the performance of our investment banking division;
- the impact of certain institutional, sales and trading client pricing arrangements on brokerage revenues;
- the potential for larger and more frequent capital commitments in our trading and underwriting business to increase losses;
- the potential for increased competition in the asset management sector to affect our ability to raise capital and generate positive economic results;
- the impact of investment performance and redemptions on our asset management business;
- the potential for fluctuations in the global credit markets to affect our CLO investments;
- the impact of principal investment activities on our capital base;
- exposure to volatile and illiquid securities and their impact on our business;

- the ongoing fluctuations in the credit markets, including reduced access to capital and liquidity, and the costs of credit;
  
- the impact of our increased leverage as a result of our January 2013 offering of 8.00% Senior Notes due 2023 (the “2013 Senior Notes”) and the January 2014 offering of 7.25% Senior Notes due 2021 (the “2014 Senior Notes,” together with the 2013 Senior Notes, the “Senior Notes”);
  
- the impact of SEC, Financial Industry Regulatory Authority (“FINRA”), and various other self-regulatory organization requirements on our business;
  
- the potential for risks related to infrastructure and operations to impact our business;
  
- the potential for increased scrutiny of financial services firms to adversely impact our business;
  
- the business risks posed by, potential conflicts of interest, employee misconduct, and business partner misconduct; and
  
- the challenges posed when valuing non-marketable investments.

The foregoing list of risks is not exhaustive. Other sections of this Form 10-K may include additional factors which could adversely impact our business and financial performance. Moreover, we operate in a very competitive and rapidly changing environment. New risks emerge from time to time and it is not possible for us to predict all risks, nor can we assess the impact of all factors or the effect which any factor, or combination of factors, may have on our business. Actual results may differ materially from those contained in any forward-looking statements.

Although we believe the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should not rely upon forward-looking statements as predictions of future events. We undertake no duty to update any of these forward-looking statements after the date of this Form 10-K to conform prior statements to actual results or revised expectations unless otherwise required by law.

## Item 1. Business

### Overview

JMP Group, Inc., together with its subsidiaries (collectively, “the Company“, “we“ or “us“), is a full-service investment banking and asset management firm. We provide investment banking, sales and trading, and equity research services to corporate and institutional clients, and alternative asset management products and services to institutional investors and high net-worth individuals. In addition, we manage and invest in corporate credit instruments through collateralized loan obligations and direct investments, and we serve as the investment advisor to a business development company under the Investment Company Act of 1940.

We focus our efforts on small and middle-market companies in the following four growth industries: financial services, healthcare, real estate, and technology. Our specialization in these areas has enabled us to develop recognized expertise and to cultivate extensive industry relationships. As a result, we have established our firm as a key advisor for our corporate clients, a trusted resource for institutional investors, and an effective investment manager for our asset management clients. We currently operate from our headquarters in San Francisco and from additional offices in New York, Boston, Chicago, Minneapolis, and outside Philadelphia and Atlanta.

We provide our corporate clients with a wide variety of services, including strategic advice and capital raising solutions, sales and trading support, and equity research coverage. We provide institutional investors with capital markets intelligence and objective, informed investment recommendations about individual equities that are not widely followed. We believe that our concentration on small and middle-market companies, as well as our broad range of product offerings, positions us as a leader in what has traditionally been an underserved and high-growth market.

The selection of our four target industries, the development of multiple products and services and the establishment of our four revenue-producing business lines—investment banking, sales and trading, equity research and asset management—has created a diversified business model, especially when compared to that of our more specialized competitors. We have been able to balance somewhat volatile revenue streams from our investment banking activities and incentive-based asset management fees with more stable revenue streams from our sales and trading commissions and base asset management fees. In addition, our target industries have historically performed, in certain respects, counter-cyclically to one another, allowing us to win business and generate revenues in various economic and capital markets conditions. In 2009, as part of our ongoing efforts to diversify our asset management business, we acquired a corporate credit business that operates as a manager of CLOs. As of December 31, 2013, we managed three CLOs with approximately \$782 million of assets under management. In 2011, we launched a specialty finance company that provides customized financing to small and midsized businesses. In May 2013, this specialty finance company converted into a business development company under the Investment Company Act of 1940 named Harvest Capital Credit Corporation (“HCC”), and completed an initial public offering. We are serving as HCC’s investment advisor through HCAP Advisors LLC (“HCAP Advisors”), our majority-owned subsidiary.

JMP Group Inc. was incorporated in Delaware in January 2000. Our headquarters are located at 600 Montgomery Street, Suite 1100, San Francisco, California 94111, and our telephone number is (415) 835-8900. We completed our initial public offering in May 2007, and our common stock is currently listed on the New York Stock Exchange (the “NYSE”) under the symbol “JMP”.

## **Principal Business Lines**

We conduct our brokerage business through JMP Securities LLC (“JMP Securities”), our asset management business through Harvest Capital Strategies LLC (“HCS”) and HCAP Advisors, our corporate credit business through JMP Credit Corporation (“JMP Credit”) and JMP Credit Advisors LLC (“JMP Credit Advisors”), and certain principal investments through JMP Capital LLC (“JMP Capital”).

JMP Securities is a U.S. registered broker-dealer under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and is a member of 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. JMP Securities provides equity research, sales and trading to institutional brokerage clients and capital raising and strategic advisory services to corporate clients. As of December 31, 2013, JMP Securities had 189 full-time employees, including 50 in equity research, 48 in sales and trading, 57 in investment banking and 34 in operations and administration.

HCS is a registered investment advisor under the Investment Advisers Act of 1940, as amended, and provides investment management services for sophisticated investors through investment partnerships and other entities managed by HCS. HCAP Advisors is a majority owned subsidiary and manages the investment activities of HCC, a business development company focused on providing customized financing solutions to small to mid-sized companies. During the fiscal year ended December 31, 2013, HCS actively managed a family of six hedge funds, one hedge fund of funds, two private equity funds, and Harvest Capital Credit LLC (“HCC LLC”) (through May 2, 2013). As of December 31, 2013, HCS had 28 full-time employees and HCAP Advisors had four full-time employees.

JMP Credit Advisors LLC is an asset management platform established to underwrite and manage investments in senior secured debt. JMP Credit Advisors LLC and its subsidiaries, including Cratos CDO Management, LLC and Capital Management, LLC (collectively, “JMP Credit Advisors”), actively manage Cratos CLO I, Ltd. (“CLO I”), JMP Credit Advisors CLO II Ltd (“CLO II”) (effective April 30, 2013) and JMP Credit Advisors CLO III Ltd. (“CLO III”) (effective December 11, 2013). As of December 31, 2013, JMP Credit Advisors had 14 full-time employees.

### *Investment Banking*

Our investment banking professionals provide capital raising, mergers and acquisitions transaction and other strategic advisory services to corporate clients. Dedicated industry coverage groups serve each of our four target industries, enabling our investment bankers to develop expertise in specific markets and to form close relationships with corporate executives, private equity investors, venture capitalists and other key industry participants. We offer our clients a high level of attention from senior personnel and have designed our organizational structure so that the investment bankers who are responsible for securing and maintaining client relationships also actively participate in providing all related transaction execution services to those clients.

By focusing consistently on our target industries—financial services, healthcare, real estate, and technology—we have developed a comprehensive understanding of the unique challenges and demands involved in executing corporate finance and strategic advisory assignments in these sectors. A significant portion of our corporate finance revenues is earned from small and mid-capitalization public companies, and the balance is earned from private companies. Some of our clients retain us for our advisory and capital raising capabilities during an accelerated growth phase as a private company and then continue to work with us through an initial public offering or company sale process. We maintain exceptional client focus both during and following a transaction, leading to a true advisory relationship and a pattern of assisting companies with multiple transactions.

### *Corporate Finance*

We assist our publicly traded and privately held corporate clients with capital raising activities, which include the underwriting of a wide range of equity and debt securities, including common, preferred and convertible securities. Our public equity underwriting capabilities include initial public offerings and follow-on equity offerings. We also act as an agent in private placements of equity and debt securities and arrange private investments in public equity (“PIPE”) transactions as well as privately negotiated, registered direct stock offerings on behalf of our public company clients. We typically place securities with our client base of institutional investors, private equity and venture capital funds and high net-worth individuals.

Because our corporate clients are generally considered high-growth companies, they are frequently in need of new capital. Many of our client relationships develop early, when a client company is still private, in which case we may facilitate private placements of the clients’ securities. Thereafter, if our client prepares for an initial public offering, we are generally considered to act as an underwriter of that stock offering. Our ability to structure innovative private offerings and to identify the likely buyers of such offerings makes us a valuable advisor for many small and middle-market companies, as does our industry specialization. We expect that, while the environment for initial public offerings may not be consistently favorable in the future, we should be able to depend on follow-on offerings, PIPEs, registered direct offerings and private placements to continue to generate corporate finance revenues.



*Mergers and Acquisitions and Other Strategic Advisory*

We work with corporate clients on a broad range of strategic matters, including mergers and acquisitions, divestitures and corporate restructurings, valuations of businesses and assets, and fairness opinions and special committee assignments. Because we serve a variety of corporate clients, from emerging growth companies to mature private and public companies, the values of these transactions range in size.

We provide our advice to senior executives and boards of directors of client companies in connection with transactions that are typically of significant strategic and financial importance to these companies. We believe that our success as a strategic advisor stems from our ability to structure and execute complex transactions that create long-term stockholder value.

Because of our focus on innovative and fast-growing companies, we are most often an advisor in company sale transactions, although we are taking steps to create equilibrium in our advisory business and expect, in addition, to increasingly represent corporate clients as buyers over time. We believe that our position as a lead manager or senior co-manager of public and private equity offerings will facilitate the growth of our mergers and acquisitions and strategic advisory businesses, as companies that have been issuers of securities become more mature and pursue acquisitions or other exit events for their investors.

*Sales and Trading*

Our sales and trading operation distributes our equity research product and communicates our proprietary investment recommendations to our institutional investors. In addition, our sales and trading staff executes equity trades on behalf of our institutional clients and markets the securities of companies for which we act as an underwriter.

We have established a broad institutional client base rooted in longstanding relationships, which have been developed through a consistent focus on the investment and trading objectives of our clients. Our sales and trading professionals work closely with our equity research staff to provide insight and differentiated investment advice to approximately 500 institutional clients nationwide.

We believe that our sales and trading clients turn to us for timely, informed investment advice. Our equity research features proprietary themes and actionable ideas about industries and companies that are not widely evaluated by many other research providers. Many peer firms focused on small capitalization companies have shut down or have been purchased by other firms. Additionally, with the failure or consolidation of several very large investment banking firms, the amount of market-making activity, liquidity and research coverage provided by broker-dealers for

smaller companies has significantly decreased. However, we continue to commit sales and trading resources to smaller-capitalization companies with the belief that institutional investors require and value such specialized knowledge and service.

Our sales and trading personnel are also central to our ability to market equity offerings and provide after-market support. Our capital markets group manages the syndication, marketing, execution and distribution of the security offerings we manage. Our syndicate activities include coordinating the marketing and order-taking process for underwritten transactions and conducting after-market stabilization and initial market-making. Our syndicate staff is also responsible for developing and maintaining relationships with the syndicate departments of other investment banks.

***Equity Research***

Our research department is charged with developing proprietary investment themes, anticipating sector and cyclical changes, and producing action-oriented reports that will assist our clients with their investment decisions. Our analysts cultivate primary sources of information in order to refine their quantitative and qualitative assessments. Our objective is to provide clients with a clear understanding of industry-specific and company-specific issues that can impact their portfolio returns.

Our equity research focuses on our four target industries—financial services, healthcare, real estate and technology—and on the following sectors underlying each industry:

| <b>Financial Services</b>  | <b>Healthcare</b>   | <b>Real Estate</b>  | <b>Technology</b>  |
|--|---|---|--|
| <ul style="list-style-type: none"> <li>• Asset Managers</li> </ul>                       | <ul style="list-style-type: none"> <li>• Biotechnology</li> </ul>         | <ul style="list-style-type: none"> <li>• Housing</li> </ul>           | <ul style="list-style-type: none"> <li>• Cloud Computing Technologies</li> </ul> |
| <ul style="list-style-type: none"> <li>• Commercial Finance</li> </ul>                   | <ul style="list-style-type: none"> <li>• Healthcare Facilities</li> </ul> | <ul style="list-style-type: none"> <li>• Land Development</li> </ul>  | <ul style="list-style-type: none"> <li>• Communications Equipment</li> </ul>     |
| <ul style="list-style-type: none"> <li>• Consumer Finance</li> </ul>                     | <ul style="list-style-type: none"> <li>• Healthcare IT</li> </ul>         | <ul style="list-style-type: none"> <li>• Lodging</li> </ul>           | <ul style="list-style-type: none"> <li>• Digital Media</li> </ul>                |
| <ul style="list-style-type: none"> <li>• Financial Processing and Outsourcing</li> </ul> | <ul style="list-style-type: none"> <li>• Healthcare Services</li> </ul>   | <ul style="list-style-type: none"> <li>• Property Services</li> </ul> | <ul style="list-style-type: none"> <li>• Internet</li> </ul>                     |
| <ul style="list-style-type: none"> <li>• Insurance</li> </ul>                            | <ul style="list-style-type: none"> <li>• Medical Devices</li> </ul>       | <ul style="list-style-type: none"> <li>• REITs</li> </ul>             | <ul style="list-style-type: none"> <li>• Internet Security</li> </ul>            |
| <ul style="list-style-type: none"> <li>• Investment Banks &amp; Brokers</li> </ul>       | <ul style="list-style-type: none"> <li>• Molecular Diagnostics</li> </ul> |   | <ul style="list-style-type: none"> <li>• Software</li> </ul>                     |
| <ul style="list-style-type: none"> <li>• Market Structure</li> </ul>                     |   |   | <ul style="list-style-type: none"> <li>• Wireless Technologies</li> </ul>        |

- Mortgage Finance
  
- Specialty Finance

As of December 31, 2013, our research department included 21 publishing research analysts providing investment recommendations on 384 public companies. Approximately 38% of the stocks under coverage had market capitalizations of less than \$1.0 billion and were divided among our target sectors as follows:

While many larger firms have restructured their research departments due to economic and regulatory pressures and have significantly reduced coverage of companies below certain market-capitalization thresholds, we continue to devote the majority of our resources to smaller-capitalization companies. The number of investment funds and the total assets under management committed to small-capitalization and mid-capitalization companies has grown considerably during the last decade. However, managers of these funds are now presented with fewer sources of independent investment research. We continue to provide objective investment recommendations on small and middle-market companies, and we believe that our institutional investor clients depend on us for this informed, fundamental research.

### *Asset Management*

Through HCS and HCAP Advisors, we actively manage a family of six hedge funds, one hedge fund of funds, two private equity funds, and one entity formed to provide loans to small to mid-size U.S. companies. As of December 31, 2013, we had a total of \$912.3 million in client assets under management (including assets of employees and portfolio managers) and had an additional \$48.2 million of our own capital invested in these vehicles. In addition, as of December 31, 2013, we had invested \$6.2 million in funds managed by certain third parties.

The objective of our multiple strategies is to diversify both revenue and risk while maintaining the attractive economics of the alternative asset management model. We view asset management as an attractive business due to its high margins and the recurring nature of its fee-based revenues as well as its dependence on intellectual capital, which we believe is less susceptible to competitive threats from larger financial institutions.

In the course of advising clients on strategic or private capital raising transactions, our investment bankers may opportunistically identify instances in which we could commit our own capital to transactions for which we are acting as an agent. In addition, opportunities to deploy equity and debt capital are frequently brought to the attention of our asset management professionals. As a result, in the past we have made, and expect that in the future we may make, principal investments in selected cases and may be able to earn attractive returns on the capital committed.

### *Corporate Credit*

JMP Credit Advisors serves as the investment manager to CLO I, CLO II and CLO III which had a diversified portfolio of 374 corporate loans with an aggregate par amount of \$735.9 million and restricted cash available to lend of \$46.1 million as of December 31, 2013. For the year ended December 31, 2013, JMP Credit Advisors earned management fees of \$3.2 million or 50 bps annualized on gross assets under management from CLO I and CLO II. As we consolidate the CLOs, in accordance with U.S. Generally Accepted Accounting Principles ("GAAP"), the management fees earned from them are eliminated on consolidation.

HCAP Advisors manages HCC for the purpose of making investments in the form of subordinated debt and, to a lesser extent, senior debt and minority equity investments, primarily in privately-held small to mid-size U.S. companies. As of December 31, 2013, the HCC portfolio consisted of 19 loans with an aggregate par amount of \$69.8 million. HCAP Advisors acts as its investment advisor, earning a base management fee equal to 2% annually of the gross assets acquired with equity. JMP Credit Advisors provides HCAP Advisors with its administrative services, and is reimbursed its expenses, including the allocable percentage of the compensation costs for the employees performing services under the agreement.

## Competition

All areas of our business are subject to a high level of competition. The principal competitive factors influencing our business include the ability of our professionals, our industry expertise, client relationships, business reputation, market focus and product capabilities, and quality and price of our products and services.

Since the mid-1990s, there has been substantial consolidation among U.S. and global financial institutions. In particular, a number of large commercial banks, insurance companies and other diversified financial services firms have merged with other financial institutions or have established or acquired broker-dealers. During 2008, the failure or near-collapse of a number of very large financial institutions led to the acquisition of several of the most sizeable U.S. investment banking firms, consolidating the financial industry to an even greater extent. Currently, our competitors are other investment banks, bank holding companies, brokerage firms, merchant banks and financial advisory firms. Our focus on our four target industries also subjects us to direct competition from a number of specialty securities firms and smaller investment banking boutiques that specialize in providing services to these industries.

The industry trend toward consolidation has significantly increased the capital base and geographic reach of many of our competitors. Our larger and better-capitalized competitors may be better able than we are to respond to changes in the investment banking industry, to recruit and retain skilled professionals, to finance acquisitions, to fund internal growth and to compete for market share generally. Many of these firms have the ability to offer a wider range of products than we do, including loans, deposit-taking and insurance, in addition to brokerage, asset management and investment banking services, all of which may enhance their competitive position relative to us. These firms also have the ability to support investment banking and securities products with commercial banking, insurance and other financial services revenues in an effort to gain market share, which could result in downward pricing pressure in our businesses. In particular, the trend in the equity underwriting business toward multiple book runners and co-managers has increased the competitive pressure in the investment banking industry and has placed downward pressure on average transaction fees.

As we seek to expand our asset management business, we face competition in the pursuit of investors for our investment funds, in the identification and completion of investments in attractive portfolio companies or securities, and in the recruitment and retention of skilled asset management professionals.

Net interest income from our corporate credit business depends, in large part, on our ability to acquire loans with yields that exceed our borrowing costs. A number of entities compete with us to make the types of investments which we make. We compete with other CLO managers, business development companies, public and private funds, commercial and investment banks and commercial finance companies. Some competing entities may have investment objectives that overlap with ours, which may create competition for investment opportunities. Some competitors may have a lower cost of funds than us and access to financing sources that are not available to us. In addition, some of our competitors may have higher risk tolerances or different risk assessments, which could allow them to consider a wider

variety of investments and establish more relationships than us.

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## **Employees**

As of December 31, 2013, we had 235 employees, including 81 managing directors. We believe that our managing directors and other professionals have been attracted to our firm because of our entrepreneurial culture, our focused industry coverage and our dedication to providing growth companies and growth investors with exceptional client service, objective advice and innovative solutions. None of our employees are subject to any collective bargaining agreements, and we believe our relationship with our employees to be satisfactory.

## **Risk Management and Compliance**

As an investment bank, risk is an inherent part of our business. Global markets, by their nature, are prone to uncertainty and subject participants to a variety of risks. The principal risks we face are market, liquidity, credit, legal, reputational and operational risks. We believe that we apply quantitative analysis and sound practical judgment before engaging in transactions to ensure that appropriate risk mitigants are in place. We accomplish this objective by carefully considering the amount of capital allocated to each of our businesses, establishing trading limits, setting credit limits for individual counterparties and, to the extent that we make principal investments, committing capital to transactions where we believe we have the advantage of industry or company-specific expertise. As part of our corporate credit and principal investment activities, we conduct due diligence before making any significant capital commitment in order to assess the risk inherent in a transaction and all significant investments must be approved by our investment committee and/or board of directors. All of our participations in underwritten offerings are evaluated and approved by a committee of key capital markets, investment banking, compliance and legal professionals. Our focus is balancing risk and return. We seek to achieve adequate returns from each of our businesses commensurate with the risks they assume. Nonetheless, the effectiveness of our approach to managing risks can never be completely assured. For example, unexpected large or rapid movements or disruptions in one or more markets or other unforeseen developments could have an adverse effect on our results of operations and financial condition. The consequences of these developments can include losses due to adverse changes in our principal investments and marketable security values, decreases in the liquidity of trading positions, increases in our credit exposure to customers and counterparties, and increases in general systemic risk.

## **Regulation**

As a participant in the financial services industry, we are subject to complex and extensive regulation of most aspects of our business by U.S. federal and state regulatory agencies, self-regulatory organizations and securities exchanges. The laws, rules and regulations comprising the regulatory framework are constantly changing, as are the interpretation and enforcement of existing laws, rules and regulations. The effect of any such changes cannot be predicted and may direct the manner of our operations and affect our profitability.



Our broker-dealer subsidiary, JMP Securities, is subject to regulations governing every aspect of the securities business, including the execution of securities transactions; capital requirements; record-keeping and reporting procedures; relationships with customers, including the handling of cash and margin accounts; the experience of and training requirements for certain employees; and business interactions with firms that are not members of regulatory bodies.

JMP Securities is registered as a securities broker-dealer with the SEC and is a member of FINRA. FINRA is a self-regulatory body composed of members such as our broker-dealer subsidiary that have agreed to abide by the rules and regulations of FINRA. FINRA may expel, fine and otherwise discipline member firms and their employees. JMP Securities is also licensed as a broker-dealer in each of the 50 states in the U.S., requiring us to comply with the laws, rules and regulations of each state. Each state may revoke the license to conduct securities business, fine and otherwise discipline broker-dealers and their employees.

JMP Securities is also subject to the SEC's Uniform Net Capital Rule, Rule 15c3-1, which may limit our ability to make withdrawals of capital from our broker-dealer subsidiary. The Uniform Net Capital Rule sets the minimum level of net capital a broker-dealer must maintain and also requires that a portion of its assets be relatively liquid. In addition, JMP Securities is subject to certain notification requirements related to withdrawals of excess net capital.

We are also subject to the USA PATRIOT Act of 2001 (the "Patriot Act"), which imposes obligations regarding the prevention and detection of money-laundering activities, including the establishment of customer due diligence and customer verification, and other compliance policies and procedures. The conduct of research analysts is also the subject of rule-making by the SEC, FINRA and the federal government through the Sarbanes-Oxley Act. These regulations require certain disclosures by, and restrict the activities of, research analysts and broker-dealers, among others. Failure to comply with these requirements may result in monetary, regulatory and, in the case of the USA Patriot Act, criminal penalties.

Our asset management subsidiaries, HCS, JMP Capital Advisors, and HCAP Advisors, are SEC-registered investment advisers, and accordingly subject to regulation by the SEC. Requirements under the Investment Advisors Act of 1940 include record-keeping, advertising and operating requirements, and prohibitions on fraudulent activities.

Various regulators, including the SEC, FINRA and state securities regulators and attorneys general, are conducting both targeted and industry-wide investigations of certain practices relating to the financial services industry, including marketing, sales practices, valuation practices, asset managers, and market and compensation arrangements. These investigations, which have been highly publicized, have involved mutual fund companies, broker-dealers, hedge funds, investors and others.

In addition, the SEC staff has conducted studies with respect to soft dollar practices in the brokerage and asset management industries and proposed interpretive guidance regarding the scope of permitted brokerage and research services in connection with soft dollar practices.

In July 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”). The Dodd-Frank Act institutes a wide range of reforms that will impact financial services firms and requires significant rule-making. In addition, the legislation mandates multiple studies, which could result in additional legislative or regulatory action. Many of the provisions of the Dodd-Frank Act are subject to further rulemaking procedures and studies and will take effect over several years. As a result, we cannot assess the impact of these new legislative and regulatory changes on our business at the present time.

### **Accounting, Administration and Operations**

Our accounting, administration and operations personnel are responsible for financial controls, internal and external financial reporting, compliance with regulatory and legal requirements, office and personnel services, management information and telecommunications systems and the processing of our securities transactions. We use a third-party service provider for payroll processing and servicing of asset-backed securities issued, and our clearing operations are currently performed by J.P. Morgan Clearing Corp. All of our data processing functions are performed by our management information systems personnel. We believe that our continued future growth will require implementation of new and enhanced communications and information systems and training of our personnel or the hiring of an outsourced provider to operate such systems. Any difficulty or significant delay in the implementation or operation of new systems or the training of personnel could harm our ability to manage growth.

### **Available Information**

We are required to file current, annual and quarterly reports, proxy statements and other information required by the Exchange Act, with the SEC. You may read and copy any document we file 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 our SEC filings.

We provide our 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 free of charge on the Investor Relations section of our website located at <http://www.jmpg.com>. These filings will become available as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC. From time to time we

may use our website as a channel of distribution of material company information.

We also make available, in the Investor Relations section of our website and will provide print copies to stockholders upon request, (i) our corporate governance guidelines, (ii) our code of business conduct and ethics, and (iii) the charters of the audit, compensation, and corporate governance and nominating committees of our board of directors. These documents, as well as the information on our website, are not intended to be part of this annual report and inclusions of our internet address in this Form 10-K are inactive textual references only.

## Item 1A. Risk Factors

### Risks Related to Our Business

*Our operations and financial results are subject to various risks and uncertainties, including those described below, which could adversely affect our business, financial condition, results of operations, cash flows, and the trading price of our common stock.*

**Difficult conditions in the global financial markets have negatively impacted and may continue to negatively impact our ability to generate business and revenues, which may cause significant fluctuations in our stock price.**

All of our businesses have been in the past and may in the future be materially affected by conditions in the financial market and general economic conditions, such as the level and volatility of interest rates, investor sentiment, the availability and the cost of credit, the U.S. mortgage market, the U.S. real estate market, volatile energy prices, consumer confidence, unemployment, and geopolitical issues. Financial markets experienced extreme volatility and disruption from mid-2007 to early 2009, and challenging conditions persisted. While financial markets have become more stable and have generally improved since 2009, there remains a certain degree of uncertainty about a global economic recovery. In particular, recent events relating to European debt markets and the possibility that EU member states may default on their debt obligations, combined with uncertainty about the global economic outlook, have led to volatility and a continuation of challenging economic conditions. The uncertainty over the outcome of international and the EU's financial support programs and the possibility that other EU member states may experience similar financial troubles could further disrupt global markets.

Weakness or disruption in equity markets and diminished trading volume of securities have adversely impacted our sales and trading business in the past and could continue to do so in the future. Industry-wide declines in the size and number of underwritings and mergers and acquisitions transactions have also had an adverse effect on our revenues. Reductions in the trading prices for equity securities tend to reduce the transaction value of investment banking transactions, such as underwriting and mergers and acquisitions transactions, which in turn may reduce the fees we earn from these transactions. Market conditions may also affect the level and volatility of securities prices and the liquidity and value of investments in our funds and managed accounts, and we may not be able to manage our investment management business's exposure to these market conditions. In addition to these factors, deterioration in the financial markets or economic conditions in the United States, EU and elsewhere in the world could materially affect our business in other ways, including the following:

- Our opportunity to act as underwriter or placement agent could be adversely affected by a reduction in the number and size of capital raising transactions or by competing government sources of equity.

The number and size of mergers and acquisitions transactions or other strategic advisory services where we act as

- adviser could be adversely affected by continued uncertainties in valuations related to asset quality and creditworthiness, volatility in the equity markets, and diminished access to financing.

- Market volatility could lead to a decline in the volume of transactions that we execute for our customers and, therefore, to a decline in the revenue we receive from commissions and spreads.

- We may experience losses in securities trading activities, or as a result of write-downs in the value of securities that we own, as a result of deteriorations in the businesses or creditworthiness of the issuers of such securities.

- We may experience losses or write downs in the realizable value of our principal investments due to the inability of companies we invest in to repay their borrowings.

- Our access to liquidity and the capital markets could be limited, preventing us from making principal investments and restricting our sales and trading businesses.

We may incur unexpected costs or losses as a result of the bankruptcy or other failure of companies for which we

- have performed investment banking services to honor ongoing obligations such as indemnification or expense reimbursement agreements.

Sudden sharp declines in market values of securities can result in illiquid markets and the failure of counterparties to

- perform their obligations, which could make it difficult for us to sell securities, hedge securities positions, and invest funds under management.

As an introducing broker to clearing firms, we are responsible to the clearing firm and could be held liable for the defaults of our customers, including losses incurred as the result of a customer's failure to meet a margin call. Although we review credit exposure to specific customers, default risk may arise from events or circumstances that

- are difficult to detect or foresee. When we allow customers to purchase securities on margin, we are subject to risks inherent in extending credit. This risk increases when a market is rapidly declining and the value of the collateral held falls below the amount of a customer's indebtedness. If a customer's account is liquidated as the result of a margin call, we are liable to our clearing firm for any deficiency.

Competition in our investment banking, sales, and trading businesses could intensify as a result of the increasing

- pressures on financial services companies and larger firms competing for transactions and business that historically would have been too small for them to consider.

- Market volatility could result in lower prices for securities, which may result in reduced management fees calculated as a percentage of assets under management.

- Market declines could increase claims and litigation, including arbitration claims from customers.
  - Our industry could face increased regulation as a result of legislative or regulatory initiatives.
  - Compliance with such regulation may increase our costs and limit our ability to pursue business opportunities.
- Government intervention may not succeed in improving the financial and credit markets and may have negative consequences for our business.

It is difficult to predict how long current financial market and economic conditions will continue, whether they will deteriorate and if they do, which of our business lines will be adversely affected. If one or more of the foregoing risks occurs, our revenues are likely to decline and, if we were unable to reduce expenses at the same pace, our profit margins would erode.

***We focus principally on specific sectors of the economy, and deterioration in the business environment in these sectors or a decline in the market for securities of companies within these sectors could harm our business.***

We focus principally on four target industries: financial services, healthcare, real estate, and technology. Volatility in the business environment in these industries or in the market for securities of companies within these industries could adversely affect our financial results and the market value of our common stock. The business environment for companies in some of these industries has been subject to high levels of volatility in recent years, and our financial results have consequently been subject to significant variations from year to year. Over the last nine years, the mix of our investment banking revenues has shifted from over 70% combined in financial services and real estate (slightly weighted in favor of the real estate sector) to 50% of total investment banking revenues in financial services and real estate in 2013. The healthcare sector has risen to 37% of total investment banking revenues in 2013 with the remaining 13% derived from the technology sector. The market for securities in each of our target industries may also be subject to industry-specific risks. For example, we have research, investment banking and principal investments focused in the areas of financial services, real estate and mortgage-related securities. These sectors have been impacted negatively by disruption in the financial markets and downturn in the general economy and the real estate market.

As an investment bank focused principally on specific growth sectors of the economy, we also depend significantly on private company transactions for sources of revenues and potential business opportunities. Most of these private company clients are initially funded and controlled by venture capital funds and private equity firms. To the extent that the pace of these private company transactions slows or the average transaction size declines due to a decrease in venture capital and private equity financings, difficult market conditions in our target industries or other factors, our business and results of operations may be harmed.

Underwriting and other corporate finance transactions, strategic advisory engagements and related sales and trading activities in our target industries represent a significant portion of our business. This concentration of activity in our target industries exposes us to the risk of declines in revenues in the event of downturns in these industries.

***Our ability to retain our senior professionals and recruit additional professionals is critical to the success of our business, and our failure to do so may adversely affect our reputation, business, results of operations and financial condition.***

Our people are our most valuable resource. Our ability to obtain and successfully execute the transactions that generate a significant portion of our revenues depends upon the reputation, judgment, business generation capabilities and project execution skills of our senior professionals, particularly our managing directors and the members of our executive committee. The reputations and relationships of our senior professionals with our clients are a critical element in obtaining and executing client engagements. Turnover in the investment banking industry is high and we encounter intense competition for qualified employees from other companies in the investment banking industry as well as from businesses outside the investment banking business, such as hedge funds and private equity funds. To the extent we continue to have annual compensation and benefits expense targets, we may not be able to retain our professionals or recruit additional professionals at compensation levels that are within our target range for compensation and benefits expense. If we were to lose the services of any of our investment bankers, senior equity research, sales and trading professionals, asset managers, or executive officers to a new or existing competitor or otherwise, we may not be able to retain valuable relationships and some of our clients could choose to use the services of a competitor instead of our services. If we are unable to retain our senior professionals or recruit additional professionals, our reputation, business, results of operations and financial condition will be adversely affected. Further, new business initiatives and efforts to expand existing businesses generally require that we incur compensation and benefits expense before generating additional revenues.

Our growth strategy also relies on our ability to attract and retain profitable senior level profitable senior level professionals across all of our businesses. Due to the early stage of development of many of our businesses and competition from other firms, we may face difficulties in recruiting and retaining professionals of a caliber consistent with our business strategy. In particular, many of our competitors are significantly larger with greater financial resources, and may be able to offer more attractive compensation packages and broader career opportunities. Additionally, it may take more than one year for us to determine whether new professionals will be profitable or effective, during which time we may incur significant expenses and expend significant time and resources on training, integration and business development.



***Certain aspects of our cost structure are largely fixed, and we may incur costs associated with new or expanded lines of business prior to these lines of business generating significant revenue. If our revenue declines or fails to increase commensurately with the expenses associated with new or expanded lines of business, our profitability may be materially adversely affected.***

We may incur costs associated with new or expanded lines of business, including guaranteed or fixed compensation costs, prior to these lines of business generating significant revenue. In addition, certain aspects of our cost structure, such as costs for occupancy, communication and information technology services, and depreciation and amortization are largely fixed, and we may not be able to timely adjust these costs to match fluctuations in revenue. If our revenue declines, or fails to increase commensurately with the expenses associated with new or expanded lines of business, our profitability may be materially adversely affected.

***We face strong competition from larger firms, some of which have greater resources and name recognition than we do, which may impede our ability to grow our business.***

The investment banking industry is intensely competitive, and we expect it to remain so. We compete on the basis of a number of factors, including client relationships, reputation, the abilities of our professionals, market focus and the relative quality and price of our services and products. We have experienced intense price competition in our various businesses. Pricing and other competitive pressures in investment banking, including the trends toward multiple book runners, co-managers and multiple financial advisors handling transactions, could adversely affect our revenues, even if the size and number of our investment banking transactions may increase.

We are a relatively small investment bank with 189 employees as of December 31, 2013. Many of our competitors have a broader range of products and services, greater financial and marketing resources, larger customer bases, greater name recognition, more senior professionals to serve their clients' needs, greater global reach and more established relationships with clients than we have. These larger and better capitalized competitors may be better able to respond to changes in the investment banking industry, compete for skilled professionals, finance acquisitions, fund internal growth and compete for market share generally. These firms have the ability to support investment banking with commercial banking, insurance and other financial services in an effort to gain market share, which has resulted, and could further result, in pricing pressure in our businesses. In particular, the ability to provide commercial financing has become an important advantage for some of our larger competitors and, because we do not provide such financing, we may be unable to compete as effectively for clients in a significant part of the investment banking industry. In addition, if the number of capital markets and financial advisory transactions continues to decline in response to current economic conditions, larger investment banking firms may seek to enter into engagements with smaller companies and for smaller transactions that traditionally would have been considered too small for these firms.

If we are unable to compete effectively with our competitors, our business, results of operations and financial condition will be adversely affected.

***We face strong competition from middle-market investment banks.***

We compete with specialized investment banks to provide financial and investment banking services to small and middle-market companies. Middle-market investment banks provide access to capital and strategic advice to small and middle-market companies in our target industries. We compete with those investment banks on the basis of a number of factors, including client relationships, reputation, the abilities of our professionals, transaction execution, innovation, price, market focus and the relative quality of our products and services. We have experienced intense competition over obtaining advisory mandates in recent years, and we may experience pricing pressures in our investment banking business in the future as some of our competitors seek to obtain increased market share by reducing fees. Competition in the middle-market may further intensify if larger Wall Street investment banks expand their focus to this sector of the market. Increased competition could reduce our market share from investment banking services and our ability to generate fees at historical levels.

We also face increased competition due to a trend toward consolidation. In recent years, there has been substantial consolidation and convergence among companies in the financial services industry. This trend was amplified in connection with the unprecedented disruption and volatility in the financial markets during the past several years, and, as a result, a number of financial services companies have merged, been acquired or have fundamentally changed their respective business models. Many of these firms may have the ability to support investment banking, including financial advisory services, with commercial banking, insurance and other financial services in an effort to gain market share, which could result in pricing pressure in our businesses.

***Our stock price has been volatile and it may continue to be volatile in the future.***

The market price of our common stock could be subject to significant fluctuations due to factors such as:

- changes in book value due to principal investment valuations;
  - actual or anticipated fluctuations in our financial condition or results of operations;
- failure to meet the expectations of securities analysts;
- a decline in the stock prices of peer companies;

- a discount in the trading multiple of our common stock relative to that of common stock of certain of our peer companies due to perceived risks associated with our smaller size;
- the success or failure of potential acquisitions, our operating strategies and our perceived prospects and those of the financial services industry in general;
- the realization of any of the other risks described in this section;
- sales of substantial amounts of our common stock by our employees or other stockholders, or the possibility of such sales; and
- changes in our dividend policy.

We currently have on file with the SEC an effective “universal” shelf registration statement on Form S-3, and we may file a new shelf registration statement to replenish the amount of securities registered. This shelf registration statement will enable us to sell, from time to time, our common stock and other securities covered by the registration statement in one or more public offerings. Sales of substantial amounts of our common stock or other securities covered by the registration statement may adversely affect the price of our common stock. Declines in the price of our common stock may adversely affect our ability to recruit and retain key employees, including our managing directors and other key professional employees. In addition, we may not be able to access the capital markets for future principal transactions.

***Our financial results from investment banking activities may fluctuate substantially from period to period, which may impair our stock price.***

We have experienced, and expect to experience in the future, significant variations from period to period in our revenues and results of operations from investment banking activities. Future variations in investment banking revenues may be attributable in part to the fact that our investment banking revenues are typically earned upon the successful completion of a transaction, the timing of which is uncertain and beyond our control. In most cases, we receive little or no payment for investment banking engagements that do not result in the successful completion of a transaction. As a result, our business is highly dependent on market conditions as well as the decisions and actions of our clients and interested third parties. For example, a client’s acquisition transaction may be delayed or terminated because of a failure to agree upon final terms with the counterparty, failure to obtain necessary regulatory consents or board or stockholder approvals, failure to secure necessary financing, adverse market conditions or unexpected financial or other problems in the business of a client or a counterparty. If the parties fail to complete a transaction on which we are advising or an offering in which we are participating, we will earn little or no revenue from the contemplated transaction. In addition, we incur significant expenses related to a contemplated transaction regardless of whether or not the contemplated transaction generates revenues. This risk may be intensified by our focus on growth companies in the financial services, healthcare, real estate and technology industries, as the market for securities of these companies has experienced significant variations in the number and size of equity offerings. In addition, our investment banking revenues are highly dependent on the level of mergers and acquisition and capital raising activity in the U.S. which fluctuates substantially from period to period. According to data from Dealogic, a provider of global investment banking analysis and systems, the number of mergers and acquisition transactions in the U.S. varied from approximately 6,150 in 2011 (\$486.8 billion in deal value) to approximately 4,700 in 2012 (\$404.0 billion in deal value) to approximately 6,133 in 2013 (\$474.3 billion in deal value). The number of capital raising transactions varied from 743 in 2012 (raising \$209.6 billion) to 1,038 in 2013 (raising \$240.8 billion). Our investment banking revenues would be adversely affected in the event that the number and size of mergers and acquisitions and capital raising transactions decline. As a result, we may not achieve steady and predictable earnings on a quarterly basis, which could in turn adversely affect our stock price.

Further, because a significant portion of our revenue is derived from investment banking fees and commissions, severe market fluctuations, weak economic conditions, a decline in stock prices, trading volumes or liquidity could cause our financial results to fluctuate from period to period as a result of the following, among other things:

- the number and size of transactions for which we provide underwriting and merger and acquisition advisory services may decline;
- the value of the securities we hold in inventory as assets, which we often purchase in connection with market-making and underwriting activities, may decline; and
- the volume of trades we would execute for our clients may decrease.

To the extent our clients, or counterparties in transactions with us, are more likely to suffer financial setbacks in a volatile stock market environment, our risk of loss during these periods would increase.

***Our corporate finance and strategic advisory engagements are singular in nature and do not generally provide for subsequent engagements.***

Our investment banking clients generally retain us on a short-term, engagement-by-engagement basis in connection with specific corporate finance, merger and acquisition transactions (often as an advisor in company sale transactions) and other strategic advisory services, rather than on a recurring basis under long-term contracts. As these transactions are typically singular in nature and our engagements with these clients may not recur, we must seek new engagements when our current engagements are successfully completed or are terminated. As a result, high activity levels in any period are not necessarily indicative of continued high levels of activity in any subsequent period. If we are unable to generate a substantial number of new engagements that generate fees from new or existing clients, our business, results of operations and financial condition could be adversely affected.

***Pricing and other competitive pressures may impair the revenues of our sales and trading business.***

We derive a significant portion of our revenues from our sales and trading business, which accounted for 17%, 22% and 23% of our net revenues for the years ended December 31, 2013, 2012 and 2011, respectively. Along with other investment banking firms, we have experienced intense price competition and trading volume reduction in this business in recent years. In particular, the ability to execute trades electronically and through alternative trading systems has increased the downward pressure on trading commissions and spreads. We expect these trends toward alternative trading systems and downward pricing pressure in the business to continue. We believe we may experience competitive pressures in these and other areas in the future as some of our competitors seek to obtain market share by competing on the basis of price or by using their own capital to facilitate client trading activities. In addition, we face pressure from our larger competitors, which may be better able to offer a broader range of complementary products and services to clients in order to win their trading business. As we are committed to maintaining and improving our comprehensive research coverage in our target sectors to support our sales and trading business, we may be required to make substantial investments in our research capabilities to remain competitive. If we are unable to compete effectively in these areas, the revenues of our sales and trading business may decline, and our business, results of operations and financial condition may be harmed.



Some of our large institutional sales and trading clients in terms of brokerage revenues have entered into arrangements with us and other investment banking firms under which they separate payments for research products or services from trading commissions for sales and trading services, and pay for research directly in cash, instead of compensating the research providers through trading commissions (referred to as “soft dollar” practices). In addition, we have entered into certain commission sharing arrangements in which institutional clients execute trades with a limited number of brokers and instruct those brokers to allocate a portion of the commission directly to us or other broker-dealers for research or to an independent research provider. If more of such arrangements are reached between our clients and us, or if similar practices are adopted by more firms in the investment banking industry, it may further increase the competitive pressures on trading commissions and spreads and reduce the value our clients place on high quality research. Conversely, if we are unable to make similar arrangements with other investment managers that insist on separating trading commissions from research products, volumes and trading commissions in our sales and trading business also would likely decrease.

***Larger and more frequent capital commitments in our trading and underwriting businesses increase the potential for significant losses.***

There is a trend toward larger and more frequent commitments of capital by financial services firms in many of their activities. For example, in order to win business, investment banks are increasingly committing to purchase large blocks of stock from publicly traded issuers or significant stockholders, instead of the more traditional marketed underwriting process in which marketing is typically completed before an investment bank commits to purchase securities for resale. We may participate in this trend and, as a result, we may be subject to increased risk. Conversely, if we do not have sufficient regulatory capital to so participate, our business may suffer. Furthermore, we may suffer losses as a result of the positions taken in these transactions even when economic and market conditions are generally favorable for others in the industry.

We may increasingly commit our own capital as part of our trading business to facilitate client sales and trading activities. The number and size of these transactions may adversely affect our results of operations in a given period. We may also incur significant losses from our sales and trading activities due to market fluctuations and volatility in our results of operations. To the extent that we own assets, i.e., have long positions, in any of those markets, a downturn in the value of those assets or in those markets could result in losses. Conversely, to the extent that we have sold assets we do not own, i.e., have short positions, in any of those markets, an upturn in those markets could expose us to potentially large losses as we attempt to cover our short positions by acquiring assets in a rising market.

***The asset management business is intensely competitive.***

Over the past several years, the size and number of asset management funds, including hedge funds and private equity funds, has continued to increase. If this trend continues, it is possible that it will become increasingly difficult for our funds to raise capital. More significantly, the allocation of increasing amounts of capital to alternative investment

strategies by institutional and individual investors leads to a reduction in the size and duration of pricing inefficiencies. Many alternative investment strategies seek to exploit these inefficiencies and, in certain industries, this drives prices for investments higher, in either case increasing the difficulty of achieving targeted returns. In addition, if interest rates were to rise or there were to be a prolonged bull market in equities, the attractiveness of our funds relative to investments in other investment products could decrease. Competition is based on a variety of factors, including:

- investment performance;
  
- investor perception of the drive, focus and alignment of interest of an investment manager;
  - quality of service provided to and duration of relationship with investors;
  
- business reputation; and
  
- level of fees and expenses charged for services.

We compete in the asset management business with a large number of investment management firms, private equity fund sponsors, hedge fund sponsors and other financial institutions. A number of factors serve to increase our competitive risks, as follows:

- investors may develop concerns that we will allow a fund to grow to the detriment of its performance;
  
- some of our competitors have greater capital, lower targeted returns or greater sector or investment strategy specific expertise than we do, which creates competitive disadvantages with respect to investment opportunities;
  
- some of our competitors may perceive risk differently than we do which could allow them either to outbid us for investments in particular sectors or, generally, to consider a wider variety of investments;
  
- there are relatively few barriers to entry impeding new asset management firms, and the successful efforts of new entrants into our various lines of business, including former “star” portfolio managers at large diversified financial institutions as well as such institutions themselves, will continue to result in increased competition; and
  
- other industry participants in the asset management business continuously seek to recruit our best and brightest investment professionals away from us.





These and other factors could reduce our earnings and revenues and adversely affect our business. In addition, if we are forced to compete with other alternative asset managers on the basis of price, we may not be able to maintain our current base management and incentive fee structures. We have historically competed primarily on the performance of our funds, and not on the level of our fees relative to those of our competitors. However, there is a risk that fees in the alternative investment management industry will decline, without regard to the historical performance of a manager, including our managers. Fee reductions on our existing or future funds, without corresponding decreases in our cost structure, would adversely affect our revenues and distributable earnings.

***Poor investment performance may decrease assets under management and reduce revenues from and the profitability of our asset management business.***

Revenues from our asset management business are primarily derived from asset management fees. Asset management fees are comprised of base management and incentive fees. Management fees are typically based on assets under management, and incentive fees are earned on a quarterly or annual basis only if the return on our managed accounts exceeds a certain threshold return, or “highwater mark,” for each investor. We will not earn incentive fee income during a particular period, even when a fund had positive returns in that period, if we do not generate cumulative performance that surpasses a highwater mark. If a fund experiences losses, we will not earn incentive fees with regard to investors in that fund until its returns exceed the relevant highwater mark.

In addition, investment performance is one of the most important factors in retaining existing investors and competing for new asset management business. Investment performance may be poor as a result of the current or future difficult market or economic conditions, including changes in interest rates or inflation, terrorism or political uncertainty, our investment style, the particular investments that we make, and other factors. Poor investment performance may result in a decline in our revenues and income by causing (i) the net asset value of the assets under our management to decrease, which would result in lower management fees to us, (ii) lower investment returns, resulting in a reduction of incentive fee income to us, and (iii) investor redemptions, which would result in lower fees to us because we would have fewer assets under management.

To the extent our future investment performance is perceived to be poor in either relative or absolute terms, the revenues and profitability of our asset management business will likely be reduced and our ability to grow existing funds and raise new funds in the future will likely be impaired.

***The historical returns of our funds may not be indicative of the future results of our funds.***

The historical returns of our funds should not be considered indicative of the future results that should be expected from such funds or from any future funds we may raise. Our rates of returns reflect unrealized gains, as of the

applicable measurement date, which may never be realized due to changes in market and other conditions not in our control that may adversely affect the ultimate value realized from the investments in a fund. The returns of our funds may have also benefited from investment opportunities and general market conditions that may not repeat themselves, and there can be no assurance that our current or future funds will be able to avail themselves of profitable investment opportunities. Furthermore, the historical and potential future returns of the funds we manage also may not necessarily bear any relationship to potential returns on our common stock.

***Our asset management clients may generally redeem their investments, which could reduce our asset management fee revenues.***

Our asset management fund agreements generally permit investors to redeem their investments with us after an initial “lockup” period during which redemptions are restricted or penalized. However, any such restrictions may be waived by us. Thereafter, redemptions are permitted at quarterly or annual intervals. If the return on the assets under our management does not meet investors’ expectations, investors may elect to redeem their investments and invest their assets elsewhere, including with our competitors. Our management fee revenues correlate directly to the amount of assets under our management; therefore, redemptions may cause our fee revenues to decrease. Investors may decide to reallocate their capital away from us and to other asset managers for a number of reasons, including poor relative investment performance, changes in prevailing interest rates which make other investments more attractive, changes in investor perception regarding our focus or alignment of interest, dissatisfaction with changes in or a broadening of a fund’s investment strategy, changes in our reputation, and departures or changes in responsibilities of key investment professionals. For these and other reasons, the pace of redemptions and corresponding reduction in our assets under management could accelerate. In the future, redemptions could require us to liquidate assets under unfavorable circumstances, which would further harm our reputation and results of operations.

***We invest our own principal capital in equities and debt that expose us to a significant risk of capital loss.***

We use a portion of our own capital in a variety of principal investment activities, each of which involves risks of illiquidity, loss of principal and revaluation of assets. At December 31, 2013, our gross principal investments included \$56.2 million invested in other investments (net of \$105.3 million related to non-controlling interest), of which \$44.6 million related to our family of funds, \$6.2 million to funds managed by third-parties, and \$4.1 million to equity securities of private companies. We also had \$29.3 million invested in marketable securities, and \$13.7 million invested through short positions on marketable securities. In addition, we have investments in private companies through loans and lines of credit, which as of December 31, 2013, are carried at \$0.8 million net of reserves for credit losses. We have \$39.9 million invested in the subordinated securities issued by the CLOs. The companies in which we invest may rely on new or developing technologies or novel business models, or concentrate on markets which are or may be disproportionately impacted by pressures in the financial services and/or mortgage and real estate sectors, have not yet developed and which may never develop sufficiently to support successful operations, or their existing business operations may deteriorate or may not expand or perform as projected. As a result, we have suffered losses in the past and we may suffer losses from our principal investment activities in the future.



***We have made and may make principal investments in relatively high-risk, illiquid assets that often have significantly leveraged capital structures, and we may fail to realize any profits from these activities for a considerable period of time or lose some or all of the principal amount we invest in these activities.***

We may purchase equity securities and, to a lesser extent, debt securities, in venture capital, seed and other high risk financings of early-stage, pre-public or “mezzanine stage”, distressed situations and turnaround companies, as well as funds or other collective investment vehicles. We risk the loss of capital we have invested in these activities.

We may use our capital, including on a leveraged basis in principal investments in both private company and public company securities that may be illiquid and volatile. The equity securities of a privately-held entity in which we make a principal investment are likely to be restricted as to resale and may otherwise be highly illiquid. In the case of fund or similar investments, our investments may be illiquid until such investment vehicles are liquidated. We expect that there will be restrictions on our ability to resell the securities of any such company that we acquire for a period of at least six months after we acquire those securities. Thereafter, a public market sale may be subject to volume limitations or dependent upon securing a registration statement for an initial and potentially secondary public offering of the securities. We may make principal investments that are significant relative to the overall capitalization of the investee company and resales of significant amounts of these securities might be subject to significant limitations and adversely affect the market and the sales price for the securities in which we invest. In addition, our principal investments may involve entities or businesses with capital structures that have significant leverage. The large amount of borrowing in the leveraged capital structure increases the risk of losses due to factors such as rising interest rates, downturns in the economy or deteriorations in the condition of the investment or its industry. In the event of defaults under borrowings, the assets being financed would be at risk of foreclosure, and we could lose our entire investment.

Even if we make an appropriate investment decision based on the intrinsic value of an enterprise, we cannot assure you that general market conditions will not cause the market value of our investments to decline. For example, an increase in interest rates, a general decline in the stock markets, or other market and industry conditions adverse to companies of the type in which we invest and intend to invest could result in a decline in the value of our investments or a total loss of our investment.

In addition, some of these investments are, or may in the future be, in industries or sectors which are unstable, in distress or undergoing some uncertainty. Such investments may be subject to rapid changes in value caused by sudden company-specific or industry-wide developments. Contributing capital to these investments is risky, and we may lose some or all of the principal amount of our investments. There are no regularly quoted market prices for a number of the investments that we make. The value of our investments is determined using fair value methodologies described in valuation policies, which may consider, among other things, the nature of the investment, the expected cash flows from the investment, bid or ask prices provided by third parties for the investment and the trading price of recent sales of securities (in the case of publicly-traded securities), restrictions on transfer and other recognized valuation methodologies. The methodologies we use in valuing individual investments are based on estimates and assumptions specific to the particular investments. Therefore, the value of our investments does not necessarily reflect the prices that would actually be obtained by us when such investments are sold. Realizations at values significantly lower than

the values at which investments have been reflected in values would result in losses of potential incentive income and principal investments.

*We may experience write downs of our investments and other losses related to the valuation of our investments and volatile and illiquid market conditions.*

We have exposure to volatile or illiquid securities, including investments in companies which have and may hold mortgage-related products, such as residential and commercial mortgage-backed securities, mortgage loans, and other mortgage and real estate-related securities. We continue to have exposure to these markets and products and as market conditions continue to evolve the fair value of these mortgage-related instruments could deteriorate.

In addition, in our principal investment activities, our concentrated holdings, illiquidity and market volatility may make it difficult to value certain of our investment securities. Subsequent valuations, in light of factors then prevailing, may result in significant changes in the values of these securities in future periods. In addition, at the time of any sales and settlements of these securities, the price we ultimately realize will depend on the demand and liquidity in the market at that time and may be materially lower than their current fair value. Any of these factors could require us to take write downs in the value of our investment and securities portfolio, which may have an adverse effect on our results of operations in future periods.

***Our businesses, profitability and liquidity may be adversely affected by deterioration in the credit quality of, or defaults by, third parties who owe us money, securities or other assets or whose securities or obligations we hold.***

The amount and duration of our credit exposures have been increasing over the past year, as have the breadth and size of the entities to which we have credit exposures. We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons. Declines in the market value of securities can result in the failure of buyers and sellers of securities to fulfill their settlement obligations, and in the failure of our clients to fulfill their credit obligations. During market downturns, counterparties to us in securities transactions may be less likely to complete transactions. In addition, particularly during market downturns, we may face additional expenses defending or pursuing claims or litigation related to counterparty or client defaults.

***Our businesses may be adversely affected by the disruptions in the credit markets, including reduced access to credit and liquidity and higher costs of obtaining credit.***

Historically, we have satisfied our need for funding from internally generated funds, the net proceeds from our 2007 initial public offering, and our revolving credit facility with City National Bank. Further, in January 2013, we raised approximately \$46.0 million from the sale of our 2013 Senior Notes and in January 2014, we raised an additional \$48.3 million from the sale of our 2014 Senior Notes. In the event existing internal and external financial resources do not satisfy our needs, we would have to seek additional outside financing. The availability of outside financing will depend on a variety of factors, such as our financial condition and results of operations, the availability of acceptable collateral, market conditions, the general availability of credit, the volume of trading activities, and the overall availability of credit to the financial services industry.

Widening credit spreads, as well as significant declines in the availability of credit, could adversely affect our ability to borrow on an unsecured basis. Disruptions in the credit markets could make it more difficult and more expensive to obtain funding for our businesses. If our available funding is limited or we are forced to fund our operations at a higher cost, these conditions may require us to curtail our business activities and increase our cost of funding, both of which could reduce our profitability, particularly in our businesses that involve investing and taking principal positions.

Liquidity, or ready access to funds, is essential to financial services firms, including ours. Failures of financial institutions have often been attributable in large part to insufficient liquidity. Liquidity is of particular importance to our sales and trading business, and perceived liquidity issues may affect the willingness of our clients and counterparties to engage in sales and trading transactions with us. Our liquidity could be impaired due to circumstances that we may be unable to control, such as a general market disruption or an operational problem that affects our sales and trading clients, third parties or us. Further, our ability to sell assets may be impaired if other market participants are seeking to sell similar assets at the same time.

Our clients engaging us with respect to mergers and acquisitions often rely on access to the secured and unsecured credit markets to finance their transactions. The lack of available credit and the increased cost of credit could adversely affect the size, volume and timing of our clients' merger and acquisition transactions—particularly large transactions—and adversely affect our investment banking business and revenues.

***Increased leverage as a result of our January 2014 offering of the 2014 Senior Notes may harm our financial condition and results of operations.***

As of December 31, 2013, our total indebtedness was approximately \$63.9 million, which consists of \$46.0 million in principal amount of 8.00% senior notes due 2023 and term loan borrowings of \$15.0 million by JMP Group LLC (“JMPG LLC”) under its credit facility. This does not include asset-backed securities of CLO I and CLO II and indebtedness of Harvest Growth Capital II (“HGC II”), which are consolidated in our financial statements, together with the loans collateralizing the asset-backed securities of the CLOs, even though the CLOs and HGC II are bankruptcy remote entities with no recourse to us. In the first quarter of 2014, we issued \$48.3 million principal amount of 7.25% senior notes due 2021. Our level of indebtedness could have important consequences to you, because:

- it could affect our ability to satisfy our financial obligations, including those relating to the Senior Notes and outstanding borrowings under JMP Group LLC's credit facility;
- a substantial portion of our cash flows from operations will have to be dedicated to interest and principal payments and may not be available for operations, working capital, capital expenditures, expansion, acquisitions or general corporate or other purposes;
- it may impair our ability to obtain additional financing in the future;
- it may limit our ability to refinance all or a portion of our indebtedness on or before maturity;
- it may limit our flexibility in planning for, or reacting to, changes in our business and industry; and
- it may make us more vulnerable to downturns in our business, our industry or the economy in general.

Our operations may not generate sufficient cash to enable us to service our debt. If we fail to make a payment on the Senior Notes or fail to maintain a minimum level of liquidity, we could be in default on the Senior Notes, and this default could cause us to be in default on our other outstanding indebtedness. Conversely, a default on our other outstanding indebtedness may cause a default under the Senior Notes. In addition, we may incur additional indebtedness in the future, and, as a result, the related risks that we now face, including those described above, could intensify. A default, if not waived, could result in acceleration of the debt outstanding under the related agreement. If that should occur, we may not be able to pay all such debt or to borrow sufficient funds to refinance it. Even if new financing were then available, it may not be on terms that are acceptable to us. The indentures for the senior notes do not restrict our ability to incur additional indebtedness.



***Increases in short term LIBOR interest rates could adversely affect the performance of our CLOs.***

An increase in prevailing interest rates could adversely affect the return on equity of the CLOs we manage. Many of the loans in CLO portfolios have variable interest rates indexed to LIBOR and subject to a LIBOR floor, which provides additional income during periods when LIBOR rates are below the floor levels. Loans with a LIBOR floor pay an interest rate of LIBOR plus the applicable margin so long as LIBOR remains above the specified floor level. If, however, LIBOR falls below the floor, the interest rate is the floor level plus the applicable margin. The asset backed securities issued by our CLOs typically have variable interest rates indexed to LIBOR, but do not have LIBOR floors. Accordingly, in a low interest rate environment, the equity holders of our CLOs benefit from a so called LIBOR floor benefit. If the LIBOR increases above the applicable LIBOR floors, the variable interest payments on the CLO asset backed securities will also increase, and the LIBOR floor benefit to us will decrease. This will diminish the return on equity of our CLOs that we hold, which could have an adverse impact on our results of operations.

***We may not receive any return on our investment in the CLOs in which we have invested and we may be unable to raise additional CLOs.***

As of December 31, 2013, we had \$39.9 million invested in the subordinated securities issued by CLOs managed by JMP Credit Advisors. Subject to market conditions, we expect to continue to acquire subordinated securities in the future in CLOs managed by JMP Credit Advisors [and/or third party managers]. These subordinated securities are the most junior class of securities issued by the CLOs and are subordinated in priority of payment to every other class of securities issued by these CLOs. Therefore, they only receive cash distributions if the CLOs have made all cash interest payments to all other debt securities issued by the CLOs. The subordinated securities are also unsecured and rank behind all of the secured creditors, known or unknown, of the CLOs, including the holders of the senior securities issued by the CLOs. Consequently, to the extent that the value of a CLOs' loan investments has been reduced as a result of conditions in the credit markets, or as a result of default loans or individual fund assets, the value of the subordinated securities at their redemption could be reduced. Additionally, we may not be able to continue to complete new CLOs due to prevailing CLO market conditions or other factors.

***We expect to enter into warehouse agreements in connection with our potential investment in and management of CLOs and other investment products, which may expose us to substantial risks.***

In connection with our potential investment in and management of new CLOs, we have entered, and expect to enter, into warehouse agreements with warehouse providers such as banks or other financial institutions, pursuant to which the warehouse provider will finance the purchase of investments that will be ultimately included in a CLO. We will typically select the investments in the warehouse subject to the approval of the warehouse provider. If the relevant CLO transaction is not issued or consummated, as applicable, the warehouse investments may be liquidated, and we may be required to pay any amount by which the purchase price of the investments exceeds its sale price and may be liable for certain of the expenses associated with the warehouse or planned CLO. In addition, regardless of whether

the CLO is issued or consummated, if any of the warehoused investments are sold before such issuance or consummation, we may have to bear any resulting loss on the sale. The amount at risk in connection with a warehouse agreement will vary and may not be limited to the amount, if any, that we invest in the related CLO upon its issuance or consummation, as applicable. Although we would expect to complete the issuance of a particular CLO within six to nine months after establishing a related warehouse, we may not be able to complete the issuance within such expected time period or at all.

***Changes in CLO spreads and an adverse market environment could continue to make it difficult for us to launch new CLOs.***

The ability to issue new CLOs is dependent, in part, on the amount by which the interest earned on the investments held by the CLO exceeds the interest payable by the CLO on the debt obligations it issues to investors and the CLO's other expenses, as well as other factors. If this excess (also known as a CLO's "arbitrage") is not sufficient, the proposed CLO will not be attractive to investors and thus cannot be issued. There may be sustained periods when CLO arbitrage will not be sufficient for us to sponsor new CLOs, which could materially impair our business. During the recent financial crisis, there was a dislocation in the credit market that significantly impeded CLO formation. Although market conditions have improved, the dislocation in credit markets could return and continue for a significant period of time. Renewed dislocation of these markets could adversely impact our results of operations and financial condition.

***Defaults, downgrades and depressed market values of the collateral underlying CLOs may cause the decline in and deferral of investment advisory income and the reduction of assets under management.***

Under the investment management agreements between JMP Credit Advisors and the CLOs it manages, payment of investment advisory fees is generally subject to a "waterfall" structure. Pursuant to these "waterfalls," all or a portion of an advisory fees may be deferred if, among other things, the CLOs do not generate sufficient cash flows to pay the required interest on the notes they have issued to investors and certain expenses they have incurred. Deferrals could occur if the issuers of the collateral underlying the CLOs default on or defer payments of principal or interest relating to such collateral. Due to severe levels of defaults and delinquencies on the assets underlying certain of the CLOs managed by us, in the past, we have both experienced declines in and deferrals of investment advisory fees. Further, during such periods and pursuant to the waterfalls, the CLOs may be required to repay certain of these liabilities, which repayment permanently reduces our assets under management and related investment advisory fees pursuant to which we can recoup deferred subordinated fees. If similar defaults and delinquencies resume, we could experience additional declines in and deferrals of their investment advisory fees.

Additionally, all or a portion of our investment advisory fees from the CLOs that we manage may be deferred if such CLOs fail to satisfy certain "over-collateralization" tests. Pursuant to the "waterfall" structure discussed above, such failures generally require cash flows to be diverted to prepay certain of the CLO's liabilities resulting in similar permanent reductions in assets under management and investment advisory fees in respect of such CLOs. Defaulted assets and assets that have been severely downgraded are generally carried at a reduced value for purposes of the over-collateralization tests. In some CLOs, these assets are required to be carried at their market values for purposes of

the over-collateralization tests. Due to exceptionally high levels of defaults, severe downgrades and depressed market values of the collateral underlying certain CLOs, some CLOs have breached their overcollateralization tests, and we have therefore experienced, and may experience in the future, declines in and deferrals of investment advisory fees which could have a material and adverse effect on us.

***We are subject to net capital and other regulatory capital requirements; failure to comply with these rules would significantly harm our business.***

JMP Securities LLC, our broker-dealer subsidiary, is subject to the net capital requirements of the SEC, FINRA, and various self-regulatory organizations of which it is a member. These requirements typically specify the minimum level of net capital a broker-dealer must maintain and also mandate that a significant part of its assets be kept in relatively liquid form. Failure to maintain the required net capital may subject a firm to limitation of its activities, including suspension or revocation of its registration by the SEC and suspension or expulsion by FINRA and other regulatory bodies, and ultimately may require its liquidation. Failure to comply with the net capital rules could have material and adverse consequences, such as:

- limiting our operations that require intensive use of capital, such as underwriting or trading activities; or

- restricting us from withdrawing capital from our subsidiaries, when our broker-dealer subsidiary has more than the minimum amount of required capital. This, in turn, could limit our ability to implement our business and growth strategies, pay interest on and repay the principal of our debt and/or repurchase our shares.

In addition, a change in the net capital rules or the imposition of new rules affecting the scope, coverage, calculation, or amount of net capital requirements, or a significant operating loss or any large charge against net capital, could have similar adverse effects.

Furthermore, JMP Securities LLC is subject to laws that authorize regulatory bodies to block or reduce the flow of funds from it to JMP Group Inc. As a holding company, JMP Group Inc. depends on dividends, distributions and other payments from its subsidiaries to fund dividend payments and to fund all payments on its obligations, including debt obligations. As a result, regulatory actions could impede access to funds that JMP Group Inc. needs to make payments on obligations, including debt obligations, or dividend payments. In addition, because JMP Group Inc. holds equity interests in the firm's subsidiaries, its rights as an equity holder to the assets of these subsidiaries may not materialize, if at all, until the claims of the creditors of these subsidiaries are first satisfied.

***There are contractual, legal and other restrictions that may prevent us from paying cash dividends on our common stock and, as a result, you may not receive any return on investment unless you sell your common stock for a price greater than the price for which you paid.***

Although we have paid a quarterly dividend on our common stock since our initial public offering, there can be no assurance that in the future sufficient cash will be available to pay such dividends, and our board of directors may at any time modify or revoke our current dividend policy. Any decision to declare and pay dividends in the future will be

made at the discretion of our board of directors and will depend on, among other things, our results of operations, financial condition, cash requirements, contractual restrictions and other factors that our board of directors may deem relevant. We do not intend to borrow funds in order to pay dividends. In addition, JMP Group Inc., the entity from which we make our dividend payments, is a holding company that does not conduct any significant business operations of its own, and therefore, it is dependent upon cash dividends and other transfers from our subsidiaries to make dividend payments on its common stock. The amounts available to us to pay cash dividends are restricted by existing and future debt agreements. In general, under the credit agreement governing our revolving lines of credit and term loans with City National Bank, JMP Group LLC is restricted under certain circumstances from paying dividends or making other distributions to us if an event of default has occurred under that agreement. The Senior Notes were issued pursuant to an indenture with U.S. Bank National Association, as trustee. The indenture contains a minimum liquidity covenant that obligates the Company to maintain liquidity of at least an amount equal to the lesser of (i) the aggregate amount due on the next eight scheduled quarterly interest payments on the Senior Notes, or (ii) the aggregate amount due on all remaining scheduled quarterly interest payments on the Senior Notes until the maturity of the Senior Notes. The indenture also contains customary event of default and cure provisions. If an uncured default occurs and is continuing, the Trustee or the holders of at least 25% in principal amount of the Senior Notes may declare the Senior Notes immediately due and payable. SEC regulations also provide that JMP Securities may not pay cash dividends to us if certain minimum net capital requirements are not met. In addition, Delaware law permits the declaration of dividends only to the extent of our surplus (which is defined as total assets at fair market value minus total liabilities, minus statutory capital), or if there is no surplus, out of our net profits for the then current and/or immediately preceding fiscal years. In the event we do not pay cash dividends on our common stock as a result of these restrictions, you may not receive any return on an investment in our common stock unless you sell your common stock for a price greater than the price for which you paid.

***We may incur losses as a result of ineffective risk management processes and strategies.***

We seek to monitor and control our risk exposure through operational and compliance reporting systems, internal controls, management review processes and other mechanisms. Our investing and trading processes seek to balance our ability to profit from investment and trading positions with our exposure to potential losses. While we employ limits and other risk mitigation techniques, those techniques and the judgments that accompany their application cannot anticipate economic and financial outcomes or the specifics and timing of such outcomes. Thus, we may, in the course of our investment and trading activities, incur losses, which may be significant.

In addition, we are investing our own capital in our funds and funds of funds as well as principal investing activities, and limitations on our ability to withdraw some or all of our investments in these funds or liquidate our investment positions, whether for legal, reputational, illiquidity or other reasons, may make it more difficult for us to control the risk exposures relating to these investments.

***Our risk management policies and procedures may leave us exposed to unidentified or unanticipated risks.***

Our risk management strategies and techniques may not be fully effective in mitigating our risk exposure in all market environments or against all types of risk. We seek to manage, monitor and control our operational, legal and regulatory risk through operational and compliance reporting systems, internal controls, management review processes and other mechanisms; however, there can be no assurance that our procedures will be fully effective. Further, our risk management methods may not effectively predict future risk exposures, which could be significantly greater than the historical measures indicate. In addition, some of our risk management methods are based on an evaluation of information regarding markets, clients and other matters that are based on assumptions that may no longer be accurate. A failure to adequately manage our growth, or to effectively manage our risk, could materially and adversely affect our business and financial condition.

We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure, and breach of contract or other reasons. We are also subject to the risk that our rights against third parties may not be enforceable in all circumstances. As an introducing broker, we could be held responsible for the defaults or misconduct of our customers. These may present credit concerns, and default risks may arise from events or circumstances that are difficult to detect, foresee or reasonably guard against. In addition, concerns about, or a default by, one institution could lead to significant liquidity problems, losses or defaults by other institutions, which in turn could adversely affect us. If any of the variety of instruments, processes and strategies we utilize to manage our exposure to various types of risk are not effective, we may incur losses.

***Our operations and infrastructure and those of the service providers upon which we rely may malfunction or fail.***

Our businesses are highly dependent on our ability to process, on a daily basis, a large number of transactions across diverse markets, and the transactions we process have become increasingly complex. The inability of our systems to accommodate an increasing volume of transactions could constrain our ability to expand our businesses. If any of these systems do not operate properly or are disabled, or if there are other shortcomings or failures in our internal processes, people or systems, we could suffer impairments, financial loss, a disruption of our businesses, liability to clients, regulatory intervention or reputational damage.

We have outsourced certain aspects of our technology infrastructure, administration and general service providers, including data centers, disaster recovery systems, and wide area networks, as well as some trading applications. We are dependent on our providers to manage and monitor those functions. A disruption of any of the outsourced services would be out of our control and could negatively impact our business. We have experienced disruptions on occasion, none of which has been material to our operations and results. However, there can be no guarantee that future disruptions with these providers will not occur. We also face the risk of operational failure, capacity constraints or termination of relations with any of the clearing agents, exchanges, clearing houses or other financial intermediaries we use to facilitate our securities transactions. As a result of the consolidation over the years among clearing agents, exchanges and clearing houses, our exposure to certain financial intermediaries has increased and could affect our ability to find adequate and cost-effective alternatives should the need arise. Any such failure, constraint or termination could adversely affect our ability to effect transactions and to manage our exposure to risk.

In addition, our ability to conduct business may be adversely impacted by a disruption in the infrastructure that supports our businesses and the communities in which we are located. This may affect, among other things, our financial, accounting or other data processing systems. This may include a disruption involving electrical, communications, transportation or other services used by us or third parties with which we conduct business, whether due to fire, serious weather conditions, earthquakes or other natural disasters, power or communications failure, act of terrorism or war or otherwise. Nearly all of our employees in our primary locations in San Francisco, New York City, Boston and Chicago work in close proximity to each other. Although we have a formal disaster recovery plan in place, if a disruption occurs in one location and our employees in that location are unable to communicate with or travel to other locations, our ability to service and interact with our clients may suffer, and we may not be able to implement successfully contingency plans that depend on communication or travel.

Our operations also rely on the secure processing, storage and transmission of confidential and other information in our computer systems and networks. Although we take protective measures and endeavor to modify them as circumstances warrant, our computer systems, software and networks may be vulnerable to unauthorized access, cyberattacks, computer viruses or other malicious code and other events that could have a security impact. Breaches of our network security systems could involve attacks that are intended to obtain unauthorized access to our proprietary information, destroy data or disable, degrade or sabotage our systems, often through the introduction of computer viruses, cyberattacks and other means and could originate from a wide variety of sources, including unknown third parties outside the firm. Although we take various measures to ensure the integrity of our systems, there can be no assurance that these measures will provide protection. If one or more of such events occur, this could jeopardize our or our clients' or counterparties' confidential and other information processed and stored in, and transmitted through, our computer systems and networks, or otherwise cause interruptions or malfunctions in our, our clients', our counterparties' or third parties' operations. We may be required to expend significant additional resources to modify our protective measures, to investigate and remediate vulnerabilities or other exposures or to make required notifications, and we may be subject to litigation and financial losses that are either not insured or not fully covered through any insurance maintained by us. If our systems are compromised, do not operate properly or are disabled, we could suffer a disruption of our business, financial losses, liability to clients, regulatory sanctions and damage to our reputation.

***We are subject to risks in using prime brokers and custodians.***

Our asset management subsidiary and its managed funds depend on the services of prime brokers and custodians to settle and report securities transactions. In the event of the insolvency of a prime broker or custodian, our funds might not be able to recover equivalent assets in whole or in part as they will rank among the prime broker's and the custodian's unsecured creditors in relation to assets which the prime broker or custodian borrows, lends or otherwise uses. In addition, cash held by our funds with the prime broker or custodian will not be segregated from the prime broker's or custodian's own cash, and the funds will therefore rank as unsecured creditors in relation thereto.

***Strategic investments or acquisitions and joint ventures, or our entry into new business areas, may result in additional risks and uncertainties in our business.***

We intend to grow our core businesses both through internal expansion and through strategic investments, acquisitions or joint ventures. When we make strategic investments, acquisitions or enter into joint ventures, we face numerous risks and uncertainties in combining or integrating the relevant businesses and systems. In addition, conflicts or disagreements between us and the other members of a venture may negatively impact our businesses. In addition, future acquisitions or joint ventures may involve the issuance of additional shares of our common stock, which may dilute your ownership in our firm. Furthermore, any future acquisitions of businesses or facilities by us could entail a number of risks, including:

- problems with the effective integration of operations;
- the inability to maintain key pre-acquisition business relationships and integrate new relationships;
- increased operating costs;
- loss of key employees or customers;
- exposure to unanticipated liabilities;
- the diversion of management's attention from our day-to-day business as a result of the need to manage any disruptions and difficulties and the need to add management resources to do so;
- risks of misconduct by employees not subject to our control;
- difficulties in realizing projected efficiencies, synergies and cost savings; and



- exposure to new or unknown liabilities.

Any future growth of our business, such as further expansion of our asset management or principal investment activities, may require significant resources and/or result in significant unanticipated losses, costs or liabilities. In addition, expansions, acquisitions or joint ventures may require significant managerial attention, which may be diverted from our other operations. These capital, equity and managerial commitments may impair the operation of our businesses.

## **Risks Related to Our Industry**

*Financial services firms have been subject to increased scrutiny over the last several years, increasing the risk of financial liability and reputational harm resulting from adverse regulatory actions.*

Firms in the financial services industry have been operating in a difficult regulatory environment which we expect will become even more stringent in light of recent well-publicized failures of regulators to detect and prevent fraud. The industry has experienced increased scrutiny from a variety of regulators, including the SEC, the NYSE, FINRA and state attorneys general. Penalties and fines sought by regulatory authorities have increased substantially over the last several years. This regulatory and enforcement environment has created uncertainty with respect to a number of transactions that had historically been entered into by financial services firms and that were generally believed to be permissible and appropriate. We may be adversely affected by changes in the interpretation or enforcement of existing laws and rules by these governmental authorities and self-regulatory organizations. Each of the regulatory bodies with jurisdiction over us has regulatory powers dealing with many aspects of financial services, including, but not limited to, the authority to fine us and to grant, cancel, restrict or otherwise impose conditions on the right to carry on particular businesses. For example, a failure to comply with the obligations imposed by the Exchange Act on broker-dealers and the Investment Advisers Act on investment advisers, including record-keeping, advertising and operating requirements, disclosure obligations and prohibitions on fraudulent activities, or by the Investment Company Act of 1940, could result in investigations, sanctions and reputational damage. We also may be adversely affected as a result of new or revised legislation or regulations imposed by the SEC, other U.S. or foreign governmental regulatory authorities or FINRA or other self-regulatory organizations that supervise the financial markets. Substantial legal liability or significant regulatory action against us could have adverse financial effects on us or cause reputational harm to us, which could harm our business prospects.

In addition, financial services firms are subject to numerous conflicts of interests or perceived conflicts. The SEC and other federal and state regulators have increased their scrutiny of potential conflicts of interest. We have adopted various policies, controls and procedures to address or limit actual or perceived conflicts and regularly review and update our policies, controls and procedures. However, appropriately addressing conflicts of interest is complex and difficult and our reputation could be damaged if we fail, or appear to fail, to appropriately address conflicts of interest. Our policies and procedures to address or limit actual or perceived conflicts may also result in increased costs and additional operational personnel. Failure to adhere to these policies and procedures may result in regulatory sanctions or litigation against us. For example, the research operations of investment banks have been and remain the subject of heightened regulatory scrutiny which has led to increased restrictions on the interaction between equity research analysts and investment banking professionals at securities firms. Several securities firms in the U.S. reached a global

settlement in 2003 and 2004 with certain federal and state securities regulators and self-regulatory organizations to resolve investigations into the alleged conflicts of interest of research analysts, which resulted in rules that have imposed additional costs and limitations on the conduct of our business.

Asset management businesses have experienced a number of highly publicized regulatory inquiries which have resulted in increased scrutiny within the industry and new rules and regulations for mutual funds, investment advisors and broker-dealers. Although we do not act as an investment advisor to mutual funds, we are registered as an investment advisor with the SEC and the regulatory scrutiny and rulemaking initiatives may result in an increase in operational and compliance costs or the assessment of significant fines or penalties against our asset management business, and may otherwise limit our ability to engage in certain activities. In addition, the SEC staff has conducted studies with respect to soft dollar practices in the brokerage and asset management industries and proposed interpretive guidance regarding the scope of permitted brokerage and research services in connection with soft dollar practices. The SEC staff has indicated that it is considering additional rulemaking in this and other areas, and we cannot predict the effect that additional rulemaking may have on our asset management or brokerage business or whether it will be adverse to us. For example, the SEC recently instituted a permanent ban on “naked” short sales. In addition, Congress is currently considering imposing new requirements on entities that securitize assets, which could affect our credit activities. It is impossible to determine the extent of the impact of any new laws, regulations or initiatives that may be proposed, or whether any of the proposals will become law. Compliance with any new laws or regulations could make compliance more difficult and expensive and affect the manner in which we conduct business.

***Recently enacted financial reforms and related regulations may negatively affect our business activities, financial position and profitability.***

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) institutes a wide range of reforms that will impact financial services firms and requires significant rule-making. In addition, the legislation mandates multiple studies, which could result in additional legislative or regulatory action. For example, in January 2011 the SEC released its mandated study on the effectiveness of current legal and regulatory standards for broker-dealers and investment advisers, which may result in the imposition of fiduciary duties on broker-dealers. The legislation and regulation of financial institutions, both domestically and internationally, include calls to increase capital and liquidity requirements; limit the size and types of the activities permitted; and increase taxes on some institutions. FINRA’s oversight over broker-dealers and investment advisors may be expanded, and new regulations on having investment banking and securities analyst functions in the same firm may be created. Many of the provisions of the Dodd-Frank Act are subject to further rule making procedures and studies and will take effect over several years. As a result, we cannot assess the impact of these new legislative and regulatory changes on our business at the present time. However, these legislative and regulatory changes could affect our revenue, limit our ability to pursue business opportunities, impact the value of assets that we hold, require us to change certain of our business practices, impose additional costs on us, or otherwise adversely affect our businesses. If we do not comply with current or future legislation and regulations that apply to our operations, we may be subject to fines, penalties or material restrictions on our businesses in the jurisdiction where the violation occurred. Accordingly, such new legislation or regulation could have an adverse effect on our business, results of operations, cash flows or financial condition.

***Governmental fiscal and monetary policy could adversely affect our small business lending activities, financial position and profitability.***

Our small business lending sector is affected by the fiscal and monetary policies of the federal government and its agencies. The Federal Reserve Board regulates the supply of money and credit in the U.S. Among the instruments of monetary policy available to the FRB are (a) conducting open market operations, (b) changing the discount rates of borrowings of depository institutions, and (c) changing reserve requirements against depository institutions' deposits. These methods are used in varying degrees and combinations to directly affect the availability of bank loans and deposits, as well as the interest rates charged on loans and paid on deposits. Its policies determine in large part our cost of funds for lending, investing and capital raising activities and the return we earn on those loans and investments, both of which affect our net interest margin.

***Our exposure to legal liability is significant, and damages and other costs that we may be required to pay in connection with litigation and regulatory inquiries, and the reputational harm that could result from legal action against us, could adversely affect our businesses.***

Many aspects of our business subject us to substantial risks of potential liability to customers and to regulatory enforcement proceedings by state and federal regulators. We face significant legal risks in our businesses and, in recent years, the volume of claims and amount of damages sought in litigation and regulatory proceedings against financial institutions have been increasing. Dissatisfied clients regularly make claims against securities firms and their brokers and investment advisers for, among others, negligence, fraud, unauthorized trading, suitability, churning, failure to supervise, breach of fiduciary duty, employee errors, intentional misconduct, unauthorized transactions, improper recruiting activity, and failures in the processing of securities transactions. These types of claims expose us to the risk of significant loss. Acts of fraud are difficult to detect and deter, and we cannot assure investors that our risk management procedures and controls will prevent losses from fraudulent activity. Additional risks include potential liability under securities or other laws for materially false or misleading statements made in connection with securities offerings and other transactions, employment claims, potential liability for "fairness opinions" and other advice we provide to participants in strategic transactions and disputes over the terms and conditions of complex trading arrangements. Generally, pursuant to applicable agreements, investors in our funds do not have legal recourse against us or HCS for underperformance or errors of judgment in connection with the funds, nor will any act or omission be a breach of duty to the fund or limited partner unless it constituted gross negligence or willful violation of law. At any point in time, the aggregate amount of existing claims against us could be material. While we do not expect the outcome of any existing claims against us to have a material adverse impact on our business, financial condition, or results of operations, we cannot assure you that these types of proceedings will not materially and adversely affect us. We do not carry insurance that would cover payments regarding these liabilities, with the exception of fidelity coverage with respect to certain fraudulent acts of our employees. In addition, our by-laws provide for the indemnification of our officers, directors, and employees to the maximum extent permitted under Delaware law. In the future, we may be the subject of indemnification assertions under these documents by our officers, directors or employees who have or may become defendants in litigation. These claims for indemnification may subject us to substantial risks of potential liability.

As an investment banking and asset management firm, we depend to a large extent on our reputation for integrity and high-caliber professional services to attract and retain clients. As a result, if a client is not satisfied with our services, it may be more damaging to our business than to other businesses. Moreover, our role as advisor to our clients on important underwriting or mergers and acquisitions transactions involves complex analysis and the exercise of professional judgment, including rendering “fairness opinions” in connection with mergers and acquisitions and other transactions. Therefore, our activities may subject us to the risk of significant legal liabilities to our clients and aggrieved third parties, including stockholders of our clients who could bring securities class actions against us. Our investment banking engagements typically include broad indemnities from our clients and provisions to limit our exposure to legal claims relating to our services, however, there can be no assurance that these provisions will protect us or be enforceable in all cases. As a result, we may incur significant legal and other expenses in defending against litigation and may be required to pay substantial damages for settlements and adverse judgments. We have in the past been, currently are and may in the future be subject to such securities litigation. Substantial legal liability or significant regulatory action against us could harm our results of operations or cause reputational harm to us, which could adversely affect our business and prospects. In addition to the foregoing financial costs and risks associated with potential liability, the defense of litigation has increased costs associated with attorneys’ fees. The amount of outside attorneys’ fees incurred in connection with the defense of litigation could be substantial and might materially and adversely affect our results of operations as such fees occur. Securities class action litigation in particular is highly complex and can extend for a protracted period of time, thereby substantially increasing the costs incurred to resolve this litigation.

***Our failure to deal appropriately with conflicts of interest could damage our reputation and adversely affect our business.***

As we have expanded the number and scope of our businesses, we increasingly confront potential conflicts of interest relating to our and our funds’ and clients’ investment and other activities. Certain of our funds have overlapping investment objectives, including funds which have different fee structures, and potential conflicts may arise with respect to our decisions regarding how to allocate investment opportunities among ourselves and those funds. For example, a decision to acquire material non-public information about a company while pursuing an investment opportunity for a particular fund gives rise to a potential conflict of interest when it results in our having to restrict the ability of the Company or other funds to take any action.

In addition, there may be conflicts of interest regarding investment decisions for funds in which our officers, directors and employees, who have made and may continue to make significant personal investments in a variety of funds, are personally invested. Similarly, conflicts of interest may exist or develop regarding decisions about the allocation of specific investment opportunities between the Company and the funds.

We also have potential conflicts of interest with our investment banking and institutional clients including situations where our services to a particular client or our own proprietary or fund investments or interests conflict or are perceived to conflict with a client. It is possible that potential or perceived conflicts could give rise to investor or client dissatisfaction or litigation or regulatory enforcement actions. Appropriately dealing with conflicts of interest is

complex and difficult and our reputation could be damaged if we fail, or appear to fail, to deal appropriately with one or more potential or actual conflicts of interest. Regulatory scrutiny of, or litigation in connection with, conflicts of interest would have a material adverse effect on our reputation, which would materially adversely affect our business in a number of ways, including as a result of redemptions by our investors from our hedge funds, an inability to raise additional funds and a reluctance of counterparties to do business with us.

***Misconduct by our employees or by the employees of our business partners could harm us and is difficult to detect and prevent.***

There have been a number of highly publicized cases involving fraud or other misconduct by employees in the financial services industry in recent years, and we run the risk that employee misconduct could occur at our firm. For example, misconduct could involve the improper use or disclosure of confidential information, which could result in regulatory sanctions and serious reputational or financial harm. It is not always possible to deter misconduct and the precautions we take to detect and prevent this activity may not be effective in all cases. Our ability to detect and prevent misconduct by entities with whom we do business may be even more limited. We may suffer reputational harm for any misconduct by our employees or those entities with whom we do business.

***If we were deemed an investment company under the Investment Company Act of 1940, applicable restrictions could make it impractical for us to continue our business as contemplated and could have an adverse effect on our business.***

We are not an investment company under the Investment Company Act of 1940. However, if we were to cease operating and controlling the business and affairs of JMP Securities and HCS or if either of these subsidiaries were deemed to be an investment company, our interest in those entities could be deemed an investment security for purposes of the Investment Company Act of 1940. We intend to conduct our operations so that we will not be deemed an investment company. However, we do invest some of our capital in principal investments. In addition, recent “risk retention” regulations in the European Union and under the Dodd-Frank Act require us to invest in the subordinated notes of the CLOs that we manage. If we were to be deemed an investment company, restrictions imposed by the Investment Company Act of 1940, including limitations on our capital structure and our ability to transact with affiliates, could make it impractical for us to continue our business as contemplated and would harm our business and the price of our common stock.

*Our historical financial information may not permit you to predict our costs of operations.*

Some of the historical consolidated financial information in this Form 10-K do not reflect the added costs that we expect to incur as a public company or the resulting changes that have occurred in our capital structure and operations. Because we historically operated through partnerships and limited liability companies prior to our transition to a corporation in connection with our initial public offering, we paid little or no taxes on profits and experienced lower expenses related to regulatory and reporting requirements.

### **Item 1B. Unresolved Staff Comments**

None.

### **Item 2. Properties**

We occupy four principal offices, with our headquarters located in San Francisco and other offices in New York, Boston and Chicago. We occupy additional space in Minneapolis, and in the states of Pennsylvania and Georgia. All of our properties are leased. Our San Francisco headquarters is located at 600 Montgomery Street and comprises approximately 37,810 square feet of leased space, pursuant to lease agreements expiring in 2019 and 13,920 square feet of leased space, pursuant to lease agreements expiring in 2016. In New York, we lease approximately 20,570 square feet at 450 Park Avenue pursuant to a lease agreement expiring in 2018. Our Boston office is located at 265 Franklin Street and consists of approximately 2,490 square feet of leased space pursuant to a lease agreement expiring in 2016. In Chicago, we lease approximately 4,500 square feet at 190 South LaSalle Street pursuant to a lease agreement expiring 2015. In Minneapolis, we lease approximately 300 square feet at 100 South Fifth Street pursuant to a sublease agreement expiring 2016. In the state of Pennsylvania, we lease approximately 300 square feet in Paoli at 12 Paoli Pike pursuant to a lease agreement expiring 2014. In the state of Georgia, we lease approximately 500 square feet in Atlanta at 1124 Tower Place 100 pursuant to a sublease agreement expiring in 2014, and lease approximately 5,773 square feet in Alpharetta at 3440 Preston Ridge Road pursuant to a lease agreement expiring in 2015. We sublease 3,270 square feet in San Francisco to third parties.

### **Item 3. Legal Proceedings**

We are involved in a number of judicial, regulatory and arbitration matters arising in connection with the ordinary course of 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. Our management, after consultation with legal counsel, believes that the currently known actions or threats against us will not result in any material adverse effect on our financial condition, results of operations or cash flows.

**Item 4. Mine Safety Disclosures**

Not applicable.



**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****Market Information**

Our common stock trades on the NYSE under the symbol "JMP." The following table sets forth, for the years ended December 31, 2013 and 2012, the high and low sales prices per share of our common stock, as quoted on the NYSE.

|                                     | <b>Sales Price</b> |            |
|-------------------------------------|--------------------|------------|
|                                     | <b>High</b>        | <b>Low</b> |
| <i>Year Ended December 31, 2013</i> |                    |            |
| First quarter                       | \$6.99             | \$5.58     |
| Second quarter                      | 6.94               | 5.96       |
| Third quarter                       | 7.07               | 6.15       |
| Fourth quarter                      | 7.56               | 6.14       |

|                                     | <b>Sales Price</b> |            |
|-------------------------------------|--------------------|------------|
|                                     | <b>High</b>        | <b>Low</b> |
| <i>Year Ended December 31, 2012</i> |                    |            |
| First quarter                       | \$7.88             | \$6.80     |
| Second quarter                      | 7.71               | 5.55       |
| Third quarter                       | 6.90               | 5.00       |
| Fourth quarter                      | 6.59               | 4.85       |

As of December 31, 2013, there were approximately 100 holders of record of our common stock.

**Dividend Policy**

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We currently intend to pay quarterly cash dividends on all outstanding shares of our common stock. Our board of directors declared the following dividends in the years ended December 31, 2013 and 2012:

*Year Ended December 31, 2013*

| <b>Declaration Date</b> | <b>Dividend Per Share</b> | <b>Record Date</b> | <b>Total Amount</b> | <b>Payment Date</b> |
|-------------------------|---------------------------|--------------------|---------------------|---------------------|
| March 5, 2013           | \$ 0.035                  | March 22, 2013     | \$791,661           | April 5, 2013       |
| May 2, 2013             | \$ 0.035                  | May 17, 2013       | \$775,079           | May 31, 2013        |
| July 30, 2013           | \$ 0.035                  | August 16, 2013    | \$770,320           | August 30, 2013     |
| October 29, 2013        | \$ 0.040                  | November 15, 2013  | \$871,211           | November 29, 2013   |

*Year Ended December 31, 2012*

| <b>Declaration Date</b> | <b>Dividend Per Share</b> | <b>Record Date</b> | <b>Total Amount</b> | <b>Payment Date</b> |
|-------------------------|---------------------------|--------------------|---------------------|---------------------|
| March 6, 2012           | \$ 0.030                  | March 16, 2012     | \$684,351           | March 30, 2012      |
| May 1, 2012             | \$ 0.035                  | May 18, 2012       | \$797,283           | June 1, 2012        |
| July 31, 2012           | \$ 0.035                  | August 17, 2012    | \$796,599           | August 31, 2012     |
| October 30, 2012        | \$ 0.035                  | November 16, 2012  | \$792,677           | November 30, 2012   |

Our ability to pay dividends in the future will be subject to, among other things, general business conditions within our industry, our financial condition, our operating results and legal and contractual restrictions on the payment of dividends by our subsidiaries to us or by us to our stockholders, including restrictions imposed by covenants in our debt instruments.

## Issuer Purchases of Equity Securities

The following table summarizes the stock repurchases for the fourth quarter of the year ended December 31, 2013:

| Period                                | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid<br>Per<br>Share | Total<br>Number of<br>Shares<br>Purchased<br>as Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | Maximum<br>Number<br>of<br>Shares<br>that May<br>Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs<br>(1) |
|---------------------------------------|---|--|--|--|
| October 1, 2013 to October 31, 2013   | 115,064                                   | \$ 6.41                                  | 115,064  | 1,217,287  |
| November 1, 2013 to November 30, 2013 | 65,884                                    | \$ 6.42                                  | 65,884   | 1,151,403  |
| December 1, 2013 to December 31, 2013 | 38,495                                    | \$ 7.28                                  | 38,495   | 1,112,908  |
| Total                                 | 219,443                                   |  | 219,443  |  |

- (1) On March 5, 2013, our board of directors authorized the repurchase of 1.3 million shares, and extended the authorization of all shares through December 31, 2014.

Information relating to compensation plans under which our equity securities are authorized for issuance is set forth in Part III, Item 12 of this Form 10-K.

## Stock Performance Graph

The following graph compares the cumulative total stockholder return on our common stock with the cumulative total return on the Russell 2000 Index and a peer group index for the period from December 31, 2008 to December 31, 2013. The graph and table below assume that \$100 was invested on the starting date and that dividends, if any, were reinvested on the date of payment without payment of any commissions. The performance shown in the graph and table represents past performance and should not be considered an indication of future performance.

|                           | <u>12/31/08</u> | <u>3/31/09</u> | <u>6/30/09</u> | <u>9/30/09</u> | <u>12/31/09</u> | <u>3/31/10</u> | <u>6/30/10</u> |
|---------------------------|-----------------|----------------|----------------|----------------|-----------------|----------------|----------------|
| <b>JMP Group Inc</b>      | 100.00          | 86.87          | 139.07         | 174.87         | 176.14          | 154.20         | 112.54         |
| <b>Russell 2000 Index</b> | 100.00          | 85.03          | 102.62         | 122.39         | 127.09          | 138.30         | 124.57         |
| <b>Peer Group Index</b>   | 100.00          | 89.23          | 135.33         | 172.77         | 159.65          | 150.29         | 128.92         |

|                           | <u>9/30/10</u> | <u>12/31/10</u> | <u>3/31/11</u> | <u>6/30/11</u> | <u>9/30/11</u> | <u>12/31/11</u> | <u>3/31/12</u> |
|---------------------------|----------------|-----------------|----------------|----------------|----------------|-----------------|----------------|
| <b>JMP Group Inc</b>      | 111.16         | 139.34          | 157.65         | 129.15         | 107.21         | 132.54          | 137.36         |
| <b>Russell 2000 Index</b> | 138.63         | 161.17          | 173.97         | 171.17         | 133.75         | 154.44          | 173.65         |
| <b>Peer Group Index</b>   | 133.80         | 162.19          | 165.48         | 130.72         | 76.52          | 85.81           | 108.28         |

|                           | <u>6/30/12</u> | <u>9/30/12</u> | <u>12/31/12</u> | <u>3/31/2013</u> | <u>6/30/2013</u> | <u>9/30/2013</u> | <u>12/31/2013</u> |
|---------------------------|----------------|----------------|-----------------|------------------|------------------|------------------|-------------------|
| <b>JMP Group Inc</b>      | 115.77         | 103.58         | 115.45          | 132.22           | 127.80           | 119.84           | 144.15            |
| <b>Russell 2000 Index</b> | 167.62         | 176.43         | 179.75          | 202.02           | 208.25           | 229.50           | 249.53            |
| <b>Peer Group Index</b>   | 83.65          | 88.49          | 104.07          | 117.57           | 120.93           | 135.80           | 156.35            |

Our peer group index includes the following companies in the broker-dealer industry: Cowen Group, Inc.; FBR Capital Markets Corporation; Gleacher & Co, Inc.; Jefferies Group Inc.; KBW, Inc.; Oppenheimer Holdings, Inc.; Piper Jaffray Companies, Inc.; Direct Markets Holdings Corp. (formerly Rodman & Renshaw Capital Group, Inc.); and Stifel Financial Corp. KBW, Inc. and Stifel Financial Corp. merged in February 2013. The total return calculations reflected in the foregoing graph and table were performed by Zacks Investment Research, Inc.

The information provided above under the heading “Stock Performance Graph” shall not be considered “filed” for purposes of Section 18 of the Exchange Act or incorporated by reference in any filing under the Securities Act of 1933, as amended or the Exchange Act.

**Item 6. Selected Financial Data****SELECTED CONSOLIDATED FINANCIAL DATA**

The following selected consolidated financial and other data of JMP Group Inc. should be read together with Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and the consolidated financial statements and accompanying notes appearing in Item 8 “Financial Statements and Supplementary Data” of this Form 10-K to fully understand factors that may affect the comparability of the information presented below.

The selected consolidated statements of financial condition data as of December 31, 2013 and 2012 and the selected consolidated statements of operations data for each of the three years in the period ended December 31, 2013 have been derived from our audited consolidated financial statements and accompanying notes appearing in Item 8 “Financial Statements and Supplementary Data” of this Form 10-K and should be read together with those consolidated financial statements and accompanying notes.

The selected consolidated statements of financial condition data as of December 31, 2011, 2010 and 2009 and the selected consolidated statement of operations data for the years 2010 and 2009 have been derived from audited consolidated financial statements not included in this Form 10-K. The historical results are not necessarily indicative of the results to be expected in any future period.

| <i>(In thousands, except per share data and selected data and operating metrics)</i> | <b>Year Ended December 31,</b> |             |             |             |             |
|--|--------------------------------|-------------|-------------|-------------|-------------|
|  | <b>2013</b>                    | <b>2012</b> | <b>2011</b> | <b>2010</b> | <b>2009</b> |
| <b>Statement of Operation Data</b>   |                                |             |             |             |             |
| Revenues   |                                |             |             |             |             |
| Investment banking   | \$74,173                       | \$50,982    | \$46,114    | \$45,577    | \$39,924    |
| Brokerage  | 24,625                         | 21,903      | 25,461      | 28,259      | 34,004      |
| Asset management fees  | 25,952                         | 15,775      | 19,785      | 12,231      | 20,148      |
| Principal transactions   | 20,727                         | 10,537      | 1,615       | 3,421       | 18,517      |
| Gain on sale, payoff and mark-to-market of loans                                     | 1,806                          | 7,255       | 16,997      | 39,363      | 22,268      |
| Gain on repurchase of asset-backed securities issued                                 | -                              | -           | -           | -           | 4,705       |

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|  |           |           |            |           |           |
|--|-----------|-----------|------------|-----------|-----------|
| Gain on bargain purchase   | -         | -         | -          | -         | 1,179     |
| Net dividend income  | 535       | (29 )     | 1,365      | 2,248     | 2,521     |
| Other income   | 798       | 3,800     | 4,336      | 3,466     | 2,593     |
| Non-interest revenues  | 148,616   | 110,223   | 115,673    | 134,565   | 145,859   |
| Interest income  | 33,346    | 32,898    | 33,356     | 45,162    | 35,370    |
| Interest expense   | (30,110 ) | (39,993 ) | (35,747 )  | (33,687 ) | (25,924 ) |
| Net interest (expense) income  | 3,236     | (7,095 )  | (2,391 )   | 11,475    | 9,446     |
| Provision for loan losses  | (2,637 )  | (2,206 )  | (1,728 )   | (1,327 )  | (5,821 )  |
| Total net revenues after provision for loan losses                   | 149,215   | 100,922   | 111,554    | 144,713   | 149,484   |
| Non-interest Expenses  |           |           |            |           |           |
| Compensation and benefits  | 102,432   | 66,415    | 89,017     | 95,708    | 105,179   |
| Administration   | 8,660     | 6,186     | 6,649      | 5,752     | 5,050     |
| Brokerage, clearing and exchange fees                                | 3,543     | 3,806     | 4,735      | 5,110     | 5,284     |
| Travel and business development                                      | 4,416     | 3,387     | 3,681      | 3,447     | 2,396     |
| Communications and technology  | 3,534     | 3,503     | 3,988      | 3,969     | 3,892     |
| Professional fees  | 3,953     | 3,630     | 2,955      | 3,080     | 3,589     |
| Impairment loss on purchased management contract                     | -         | -         | 700        | 2,750     | -         |
| Other  | 5,126     | 4,461     | 4,074      | 3,912     | 3,749     |
| Total non-interest expenses  | 131,664   | 91,388    | 115,799    | 123,728   | 129,139   |
| Income (loss) before income tax expense                              | 17,551    | 9,534     | (4,245 )   | 20,985    | 20,345    |
| Income tax expense (benefit)   | 3,950     | 1,581     | (1,632 )   | 8,577     | 7,663     |
| Net income (loss)  | 13,601    | 7,953     | (2,613 )   | 12,408    | 12,682    |
| Less: Net income (loss) attributable to noncontrolling interests (1) | 9,973     | 5,196     | (157 )     | 2,805     | 1,872     |
| Net income (loss) attributable to JMP Group Inc.                     | \$3,628   | \$2,757   | \$(2,456 ) | \$9,603   | \$10,810  |
| Net (loss) income per common share:                                  |           |           |            |           |           |
| Basic  | \$0.16    | \$0.12    | \$(0.11 )  | \$0.44    | \$0.52    |
| Diluted  | \$0.16    | \$0.12    | \$(0.11 )  | \$0.43    | \$0.49    |
| Dividends declared and paid per common share:                        | \$0.145   | \$0.135   | \$0.105    | \$0.055   | \$0.040   |
| Weighted average common shares outstanding:                          |           |           |            |           |           |
| Basic  | 22,158    | 22,582    | 22,118     | 21,646    | 20,791    |
| Diluted  | 23,317    | 22,906    | 22,118     | 22,396    | 22,137    |

*(Dollars in thousands)*

|   | <b>As of and Year Ended December 31,</b> |             |             |             |             |
|---|--|-------------|-------------|-------------|-------------|
|   | <b>2013</b>                              | <b>2012</b> | <b>2011</b> | <b>2010</b> | <b>2009</b> |
| <b>Statement of Financial Condition Data</b>  |  |             |             |             |             |
| Total assets  | \$1,121,931                              | \$709,862   | \$660,663   | \$638,788   | \$574,721   |
| Asset-backed securities issued  | 716,423                                  | 415,456     | 381,556     | 351,322     | 326,632     |
| Note payable/ Bond issued/ Line of credit   | 63,895                                   | 38,713      | 19,222      | 26,209      | 9,045       |
| Total liabilities   | 884,691                                  | 522,558     | 504,024     | 496,736     | 449,070     |
| Total equity  | 237,240                                  | 187,143     | 156,589     | 142,052     | 125,651     |
| <b>Selected Data and Operating Metrics</b>  |  |             |             |             |             |
| <b>(Unaudited)</b>  |  |             |             |             |             |
| Number of employees - end of period   | 235                                      | 224         | 217         | 215         | 224         |
| Number of employees - average   | 226                                      | 217         | 214         | 218         | 211         |
| Net revenues after provision for loan losses per employee                                     | \$660                                    | \$465       | \$472       | \$664       | \$708       |
| Compensation and benefits as a percentage of net revenues after provision for loan losses (2) | 68.6                                     | % 65.8      | % 79.2      | % 64.4      | % 68.2      |
| Companies covered by research analysts  | 384                                      | 340         | 342         | 317         | 286         |
| Number of completed investment banking transactions   | 171                                      | 123         | 86          | 74          | 56          |

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Non-controlling interest relate to the interest of third parties in Harvest Growth Capital LLC (from April 1, 2010), Harvest Growth Capital LLC II (from October 1, 2012), Harvest Capital Credit LLC (from August 18, 2011 (1) through May 2, 2013), Harvest Capital Advisors LLC (from May 1, 2013), Harvest Mortgage Opportunities Partners (from May 1, 2009 through December 31, 2010), CLO I (from April 7, 2009), CLO II (from April 30, 2013), and in Opportunity Acquisition Corp (through December 31, 2009).

The computation of compensation and benefits as a percentage of net revenues after provision for loan losses includes salaries, performance-based cash payments and equity awards to our managing directors and other (2) employees, but excludes compensation expense of zero, zero, \$0.8 million, \$2.6 million, and \$3.2 million for the years ended December 31, 2013, 2012, 2011, 2010 and 2009, respectively, related to equity awards granted or vested in connection with our initial public offering.



## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

*The following discussion should be read together with our consolidated financial statements and the accompanying notes appearing in Item 8 "Financial Statements and Supplementary Data" of this Form 10-K. In addition to historical information, the following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results and the timing of events may differ significantly from those projected in such forward-looking statements due to a number of factors, including those discussed in Item 1A—"Risk Factors" and elsewhere in this Form 10-K. These forward-looking statements should not be relied upon as representing our views as of any subsequent date and we undertake no obligation to update or revise forward-looking statements to reflect events or circumstances after the date they were made.*

### Overview

JMP Group Inc., together with its subsidiaries (collectively, the "Company", "we", or "us") is a full-service investment banking and asset management firm headquartered in San Francisco, California. 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 four 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 and a specialty finance company.

Our business, by its nature, does not produce predictable earnings. Our results in any given period can be materially affected by conditions in global financial markets and economic conditions generally. For a further discussion of the factors that may affect our future operating results, see "Risk Factors" in Part I, Item 1A of this Annual Report on Form 10-K.

## **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 and incentive fees in our asset management business and interest income on collateralized loan obligations and small business loans 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 capital market placements and providing advisory services in mergers and acquisitions and other strategic advisory assignments.

### *Underwriting Revenues*

We earn underwriting revenues from securities offerings in which we act as an underwriter, such as initial public offerings and follow-on equity offerings. Underwriting revenues include management fees, underwriting fees, selling concessions and realized and unrealized net gains and losses on equity positions held in inventory for a period of time to facilitate the completion of certain underwritten transactions. 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 completed, the fees are determinable and collection is reasonably assured.



### *Private Capital Market and Other Revenues*

We earn agency placement fees in non-underwritten transactions such as private placements of equity securities, private investments in public equity (“PIPE”) transactions, 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 (“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 the commitment of capital to facilitate customer orders. 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, 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 for hedge funds, hedge funds of funds, private equity funds, HCC LLC (through May 2, 2013), and HCC include base management fees and incentive fees earned from managing our family of investment partnerships and a publicly-traded specialty finance company. Earned base management fees are generally based on the fair value of assets under management or aggregate capital commitments and the fee schedule for each fund and account. We also earn incentive fees based upon the performance of investment funds and accounts. For most of the funds, such fees are based on a percentage of the excess of an investment return over a specified high-water mark or hurdle rate over a defined performance period. For private equity funds, incentive fees are based on a specified percentage of realized gains from the disposition of each portfolio investment in which each investor participates, and we earn after returning contributions by the investors for that portfolio investment and for all other portfolio investments in which each such investor participates that have been disposed of at the time of distribution. Generally, we do not earn management fees on assets calculated on an average assets under management (“AUM”) basis.

As of December 31, 2013, the contractual base management fees earned from each of these investment funds or company ranged between 1% and 2% of assets under management or were 2% of aggregate committed capital. 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 hedge funds of funds; (iii) 20%, subject to high-water marks, for Harvest Growth Capital LLC (“HGC”) and HGC II. 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. As we consolidate HGC, HGC II and HCC LLC (through May 2, 2013), the management and incentive fees earned at HCS from HGC, HGC II, and HCC LLC (through May 2, 2013), are eliminated in consolidation.

Asset management fees for the CLOs we manage currently consist only of senior and subordinated base management fees. We recognize base management fees for the CLOs on a monthly basis over the period in which the collateral management services are performed. The base management fees for the CLOs are calculated as a percentage of the average aggregate collateral balances for a specified period. As we consolidate CLO I, CLO II, and CLO III, the management fees earned at JMP Credit Advisors LLC (“JMPCA”) from the CLOs are eliminated on consolidation in accordance with accounting principles GAAP. At December 31, 2013, the contractual senior and subordinated base management fees earned from the CLOs were 0.50% of the average aggregate collateral balance for a specified period.

Redemption provisions of our funds require at least 90 days' advance notice, except for one fund that requires twelve months advance notice. The following tables present certain information with respect to the investment funds managed by HCS, HCAP Advisors, and CLOs managed by JMPCA:

| <i>(In thousands)</i>                         | <b>Assets Under Management <sup>(1)</sup> at</b> |                    | <b>Company's Share of Assets Under Management at</b> |                 |
|---|--|--------------------|--|-----------------|
|   | <b>December 31, 2013</b>                         | <b>2012</b>        | <b>December 31, 2013</b>                             | <b>2012</b>     |
| <b>Funds Managed by HCS or HCAP Advisors:</b> |  |                    |  |                 |
| <b>Hedge Funds:</b>                           |  |                    |  |                 |
| Harvest Opportunity Partners II (2)           | \$123,481  | \$111,853          | \$15,847   | \$4,506         |
| Harvest Small Cap Partners                    | 322,883  | 288,391            | 1,003  | 4,621           |
| Harvest Franchise Fund                        | 114,145  | 84,192             | 2,909  | 2,000           |
| Harvest Agriculture Select (2)                | 90,589   | 31,580             | 14,578   | 2,428           |
| Harvest Technology Partners (2)               | 42,661   | 65,877             | 10,311   | 111             |
| Harvest Diversified Partners                  | -  | 23,598             | -  | 14,241          |
| <b>Private Equity Funds:</b>                  |  |                    |  |                 |
| Harvest Growth Capital LLC (3)                | 35,130   | 39,694             | 1,649  | 1,798           |
| Harvest Growth Capital LLC II (3)             | 73,552   | 7,660              | 1,748  | 268             |
| <b>Funds of Funds:</b>                        |  |                    |  |                 |
| JMP Masters Fund                              | 50,686   | 42,182             | 139  | 109             |
| <b>REITs:</b>                                 |  |                    |  |                 |
| New York Mortgage Trust                       | 34,966   | 32,539             | N/A  | N/A             |
| <b>Loans:</b>                                 |  |                    |  |                 |
| Harvest Capital Credit LLC (3)                | -  | 47,986             | N/A  | 15,005          |
| Harvest Capital Credit Corporation            | 72,361   | -                  | N/A  | -               |
| <b>HCS Totals</b>                             | <b>\$960,454</b>                                 | <b>\$775,552</b>   | <b>\$48,184</b>                                      | <b>\$45,087</b> |
| <b>CLOs Managed by JMPCA:</b>                 |  |                    |  |                 |
| CLO I (3)                                     | 441,533  | 471,887            | N/A  | N/A             |
| CLO II (3)                                    | 330,431  | -                  | N/A  | N/A             |
| CLO III (3)                                   | 10,003   | -                  | N/A  | N/A             |
| <b>JMPCA Totals</b>                           | <b>\$781,967</b>                                 | <b>\$471,887</b>   | <b>N/A</b>   | <b>N/A</b>      |
| <b>JMP Group Inc. Totals</b>                  | <b>\$1,742,421</b>                               | <b>\$1,247,439</b> | <b>\$48,184</b>                                      | <b>\$45,087</b> |

(1) For hedge funds, private equity funds and funds of funds, assets under management represent the net assets of such funds. For New York Mortgage Trust ("NYMT"), assets under management represent certain assets for which HCS earns incentive fees. For CLOs, assets under management represent the sum of the aggregate collateral balance and restricted cash to be reinvested in collateral, upon which management fees are earned.

Harvest Opportunity Partners II (“HOP II”), Harvest Agriculture Select (“HAS”), and Harvest Technology Partners (2) (“HTP”) include managed accounts in which the Company has neither equity investment nor control. These are included as they follow the respective funds’ strategy and earn fees.

HGC, HGC II, and CLO I, CLO II, and CLO III were consolidated in the Company’s Statements of Financial (3) Condition at December 31, 2013. HGC, HGC II, HCC LLC and CLO I were consolidated in the Company’s Statements of Financial Condition at December 31, 2012.

**Funds Managed by HCS**

|                                      | <b>Hedge<br/>Funds</b> | <b>Private<br/>Equity<br/>Funds</b> | <b>Funds of<br/>Funds</b> | <b>Total</b> |
|--------------------------------------|------------------------|-------------------------------------|---------------------------|--------------|
| AUM at December 31, 2011             | \$493,904              | \$23,691                            | \$52,853                  | 570,448      |
| Contributions                        | 194,893                | 25,846                              | 332                       | 221,071      |
| Redemptions                          | (110,224)              | -                                   | (14,705)                  | (129,929)    |
| Distributions from realization event | -                      | (4,729 )                            | -                         | (4,729 )     |
| Appreciation                         | 26,918                 | 2,546                               | 3,702                     | 33,166       |
| AUM at December 31, 2012             | \$605,491              | \$47,354                            | \$42,182                  | 695,027      |
| Contributions                        | 140,050                | 52,331                              | 25                        | 192,406      |
| Redemptions                          | (139,006)              | -                                   | (3,436 )                  | (142,442)    |
| Distributions from realization event | -                      | (1,692 )                            | -                         | (1,692 )     |
| Appreciation                         | 87,224                 | 10,689                              | 11,915                    | 109,828      |
| AUM at December 31, 2013             | \$693,759              | 108,682                             | 50,686                    | 853,127      |

AUM related to hedge funds, private equity funds and funds of funds increased \$158.1 million, or 22.7%, from \$695.0 million at December 31, 2012 to \$853.1 million at December 31, 2013. This increase was primarily attributed to appreciation of \$109.8 million related to all funds managed by HCS and capital contributions of \$51.8 million related to HGC II, a private equity fund that commenced in the fourth quarter of 2012.

AUM related to hedge funds, private equity funds and funds of funds increased \$124.6 million, or 21.8%, from \$570.4 million at December 31, 2011 to \$695.0 million at December 31, 2012. This increase was primarily attributed to capital contributions of \$132.2 million related to the launch of Harvest Franchise Fund ("HFF") and new managed funds within hedge funds.

(In thousands)

**Year Ended December 31, 2013**  
**Company's**  
**Share**  
**of Management Incentive TWR**  
**Change Fee Fee (1)**  
**in Fair**  
**Value**

Hedge Funds:

|                                     |       |          |        |        |
|-------------------------------------|-------|----------|--------|--------|
| Harvest Opportunity Partners II (2) | \$865 | \$ 1,237 | \$ 357 | 5.7 %  |
| Harvest Small Cap Partners          | 413   | 5,645    | 9,097  | 13.8 % |
| Harvest Franchise Funds             | 716   | 1,107    | 3,161  | 25.1 % |
| Harvest Agriculture Select (2)      | 1,022 | 771      | 326    | 9.5 %  |
| Harvest Technology Partners (2)     | 96    | 567      | 7      | -0.2 % |



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|                                    |         |           |           |        |
|------------------------------------|---------|-----------|-----------|--------|
| Harvest Diversified Partners       | 852     | 169       | 83        | 4.8 %  |
| Private Equity Funds:              |         |           |           |        |
| Harvest Growth Capital LLC (3)     | (23 )   | 420       | 30        | N/A    |
| Harvest Growth Capital LLC II (3)  | 556     | 1,119     | -         | N/A    |
| Funds of Funds:                    |         |           |           |        |
| JMP Masters Fund                   | 29      | 432       | 1,006     | 25.9 % |
| REITs:                             |         |           |           |        |
| New York Mortgage Trust            | -       | -         | 1,103     | N/A    |
| Loans:                             |         |           |           |        |
| Harvest Capital Credit LLC (3)     | N/A     | 108       | 386       | N/A    |
| Harvest Capital Credit Corporation | N/A     | 699       | -         | N/A    |
| CLOs Managed by JMPCA:             |         |           |           |        |
| CLO I (3)                          | N/A     | 2,339     | N/A       | N/A    |
| CLO II (3)                         | N/A     | 863       | N/A       | N/A    |
| CLO III (3)                        | N/A     | 3         | N/A       | N/A    |
| Totals                             | \$4,526 | \$ 15,479 | \$ 15,556 | N/A    |

- 
- Time-weighted rate of return (“TWR”) for the hedge funds and funds of funds. TWR is a measure of the compound (1) rate of growth in a portfolio and eliminates the effect of varying cash inflows by assuming a single investment at the beginning of a period and measuring the growth or loss of market value to the end of that period.
- (2) HOP II, HAS, and HTP include managed accounts in which the Company has neither equity investment nor control. These are included as they follow the respective funds’ strategy and earn fees.
- (3) Revenues earned from HGC, HGC II, HCC LLC, and the CLOs are consolidated and then eliminated in consolidation in the Company’s Statements of Operations, net of non-controlling interest.

*(In thousands)*

|                                     | <b>Year Ended December 31, 2012</b>            |                  |                       |                      |                |
|-------------------------------------|--|------------------|-----------------------|----------------------|----------------|
|                                     | <b>Company's Share of Change in Fair Value</b> |                  | <b>Management Fee</b> | <b>Incentive Fee</b> | <b>TWR (1)</b> |
| <b>Hedge Funds:</b>                 |  |                  |                       |                      |                |
| Harvest Opportunity Partners II (2) | \$584  | \$ 756           | \$ 540                |                      | 13.2 %         |
| Harvest Small Cap Partners          | 430  | 5,473            | 3,857                 |                      | 6.1 %          |
| Harvest Franchise Funds             | (110 )   | 814              | 4                     |                      | -6.7 %         |
| Harvest Agriculture Select (2)      | 438  | 255              | 273                   |                      | 19.0 %         |
| Harvest Technology Partners (2)     | (13 )  | 953              | 618                   |                      | -3.6 %         |
| Harvest Diversified Partners        | 1,320  | 170              | 149                   |                      | 9.0 %          |
| <b>Private Equity Funds:</b>        |  |                  |                       |                      |                |
| Harvest Growth Capital LLC (3)      | 205  | 599              | 266                   |                      | N/A            |
| Harvest Growth Capital LLC II (3)   | (2 )   | 184              | -                     |                      | N/A            |
| <b>Funds of Funds:</b>              |  |                  |                       |                      |                |
| JMP Masters Fund                    | 7  | 487              | -                     |                      | 8.3 %          |
| <b>REITs:</b>                       |  |                  |                       |                      |                |
| New York Mortgage Trust             | -  | 500              | 900                   |                      | N/A            |
| <b>Loans:</b>                       |  |                  |                       |                      |                |
| Harvest Capital Credit LLC (3)      | N/A  | 228              | 525                   |                      | N/A            |
| <b>CLOs Managed by JMPCA:</b>       |  |                  |                       |                      |                |
| CLO I (3)                           | N/A  | 2,376            | N/A                   |                      | N/A            |
| <b>Totals</b>                       | <b>\$2,859</b>                                 | <b>\$ 12,795</b> | <b>\$ 7,132</b>       |                      | <b>N/A</b>     |

TWR for the hedge funds and funds of funds. TWR is a measure of the compound rate of growth in a portfolio and (1) eliminates the effect of varying cash inflows by assuming a single investment at the beginning of a period and measuring the growth or loss of market value to the end of that period.

(2) HOP II, HAS, and HTP include managed accounts in which the Company has neither equity investment nor control. These are included as they follow the respective funds' strategy and earn fees.

(3) Revenues earned from HGC, HGC II, HCC LLC, and CLO I are consolidated and then eliminated in consolidation in the Company's Statements of Operations, net of non-controlling interest.

*(In thousands)*

|  | <b>Year Ended December 31, 2011</b>            |  |                       |                      |                |
|--|--|--|-----------------------|----------------------|----------------|
|  | <b>Company's Share of Change in Fair Value</b> |  | <b>Management Fee</b> | <b>Incentive Fee</b> | <b>TWR (1)</b> |

|                                     | Value |           |           |        |
|-------------------------------------|-------|-----------|-----------|--------|
| Hedge Funds:                        |       |           |           |        |
| Harvest Opportunity Partners II (2) | \$59  | \$ 661    | \$ 96     | 0.4 %  |
| Harvest Small Cap Partners          | 735   | 5,398     | 7,569     | 13.3 % |
| Harvest Agriculture Select (2)      | (86 ) | 86        | 31        | -4.7 % |
| Harvest Technology Partners (2)     | 11    | 600       | 504       | 4.2 %  |
| Harvest Diversified Partners        | 231   | 286       | 119       | 0.5 %  |
| Private Equity Funds:               |       |           |           |        |
| Harvest Growth Capital LLC (3)      | (102) | 759       | 77        | N/A    |
| Funds of Funds:                     |       |           |           |        |
| JMP Masters Fund                    | -     | 601       | -         | -3.1 % |
| REITs:                              |       |           |           |        |
| New York Mortgage Trust             | 147   | 1,058     | 1,681     | N/A    |
| Loans:                              |       |           |           |        |
| Harvest Capital Credit LLC (3)      | N/A   | 13        | -         | N/A    |
| CLOs Managed by JMPCA:              |       |           |           |        |
| CLO I (3)                           | N/A   | 2,374     | N/A       | N/A    |
| Other (4)                           | N/A   | 1,180     | -         | N/A    |
| Totals                              | \$995 | \$ 13,016 | \$ 10,077 | N/A    |

TWR for the hedge funds and funds of funds. TWR is a measure of the compound rate of growth in a portfolio and (1) eliminates the effect of varying cash inflows by assuming a single investment at the beginning of a period and measuring the growth or loss of market value to the end of that period.

(2) HOP II, HAS, and HTP include managed accounts in which the Company has neither equity investment nor control. These are included as they follow the respective funds' strategy and earn fees.

(3) Revenues earned from HGC, HCC LLC, and the CLOs are consolidated and then eliminated in consolidation in the Company's Statements of Operations, net of non-controlling interest.

(4) The CLO within "Other" initiated liquidation proceedings in December 2011. The remaining assets were distributed in 2012.

*Principal Transactions*

Principal transaction revenues includes realized and unrealized net gains and losses resulting from our principal investments, which include 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. Principal transaction revenues also include unrealized gains and losses on the private equity securities owned by HGC and HGC II, two private equity funds managed by HCS which are consolidated in our financial statements, as well as unrealized gains and losses on the investments in private companies sponsored by HCS and JMP Capital, and unrealized gains and losses on the warrants, options and equity securities owned by HCC LLC (through May 2, 2013).

*Gain on Sale, Payoff and Mark-to-market of Loans*

Gain on sale, payoff and mark-to-market of loans consists of gains from the sale and payoff of loans collateralizing asset-backed securities at JMP Credit and small business loans at HCC LLC (through May 2, 2013). Gains are recorded when the proceeds exceed the carrying value of the loan. Gain on sale, payoff and mark-to-market of loans also consists of lower of cost or market adjustments arising from loans held for sale and fair value market adjustments of the small business loans. Losses are recorded for the loan held for sale when the carrying value exceeds fair value. Changes to the fair value of the small business loans were recorded to this line item, when HCC LLC was consolidated.

*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*

Other income includes loan restructuring fees at JMP Credit, revenues from equity method investments, and revenues from fee-sharing arrangements with, and fees earned to raise capital for third-party investment partnerships, or funds. In 2012, other income also includes non-recurring revenues associated with the conclusion of HCS's advisory

relationship with NYMT.

### *Interest Income*

Interest income primarily consists of interest income earned on loans collateralizing asset-backed securities issued, small business loans, and loans held for investment. 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. 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, and the amortization of bond issuance costs. Interest expense on asset-backed securities is the stated coupon payable as a percentage of the principal amount as well as amortization of the 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.

### *Provision for Loan Losses*

Provision for loan losses includes provision for losses recognized on our loan notes and non-revolving credit agreements at JMP Capital (collectively loans held for investment), and on loans collateralizing asset-backed securities ("ABS") at JMP Credit to record them at their estimated net realizable value. We maintain an allowance for loan losses that is intended to estimate loan losses inherent in JMP Capital's 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. Our estimate of each allowance component is based on observable information and on market and third-party data that we believe are reflective of the underlying loan losses being estimated.

A specific reserve is provided for loans that are considered impaired. A loan is considered impaired when it is probable that we will be unable to collect all amounts due according to the contractual terms of the loan agreement. We measure 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 our 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 additional 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 accordance with the guidance 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.

In addition, we provide an allowance on a loan-by-loan basis at JMP Credit for loans that were purchased after the Cratos acquisition. We employ 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. We perform periodic detailed reviews of its loan portfolio to identify risks and to assess the overall collectability of loans.

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

### **Components of Expenses**

We classify our expenses as compensation and benefits, administration, brokerage, clearing and exchange fees, travel and business development, communications and technology, professional fees, impairment loss on purchased management contract and other expenses. A significant portion of our expense base is variable, including compensation and benefits, brokerage and clearing and exchange fees, travel and business development and communication and technology 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. To certain senior professionals, a portion of the performance-based bonuses is paid in the form of deferred 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, regulatory fees, and underwriting expenses paid by HCAP Advisors in connection with an agreement with HCC.

*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 clear our securities transactions through J.P. Morgan Clearing Corp. Changes in brokerage, clearing and exchange fees fluctuate largely in line with the volume of sales and trading activity.

*Travel and Business Development*

Travel and business development expense is net of expenses reimbursed by clients.

*Communications and Technology*

Communications and technology expense primarily relates to communication and information processing as well as the subscription of certain market data.

*Professional Fees*

Professional fees primarily relate to legal and accounting professional services.

*Other Expenses*

Other operating expenses primarily include occupancy, depreciation and CLO administration expense at JMP Credit.





*Non-controlling Interest*

Non-controlling interest for the year ended December 31, 2013 includes the interest of third parties in HGC I, HGC II, CLO I, CLO II (effective April 3, 2013), HCC LLC (through May 2, 2013) and HCAP Advisors (effective May 1, 2013), partially-owned subsidiaries consolidated in our financial statements. Non-controlling interest for the year ended December 31, 2012 includes the interest of third parties in CLO I, HGC, HGC II (effective October 1, 2012) and HCC LLC, the partially-owned subsidiaries consolidated in our financial statements. Non-controlling interest for the year ended December 31, 2011 includes the interest of third parties in CLO I, HGC, and HCC LLC (effective August 18, 2011), the partially-owned subsidiaries consolidated in our financial statements.

HCS currently manages several asset management funds, which are structured as limited partnerships, and is the general partner of each. The Company assesses whether the partnerships meet the definition of a variable interest entities (“VIEs”) in accordance with ASC 810-10-15-14, and whether the Company qualifies as the primary beneficiary. Funds determined not to meet the definition of a VIE are considered voting interest entities for which the rights of the limited partners are evaluated to determine if consolidation is necessary. Such guidance provides that the presumption that the general partner controls the limited partnership may be overcome if the limited partners have substantive kick-out rights. Except for HGC and HGC II, the partnership agreements for these 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 funds, and therefore does not consolidate them except for HGC and HGC II. The Company accounts for its investments in these non-consolidated funds under the equity method of accounting.

The limited liability company agreements of HGC and HGC II do not provide for the right of the members to remove the manager by a simple majority vote of the non-affiliated members and therefore the manager (with a minority interest in the limited liability company) is deemed to control the funds. As a result, we consolidated HGC from its inception on April 1, 2010 and HGC II from its inception on October 1, 2012.

On August 6, 2010, the Company transferred 109 subordinated notes of CLO I to certain employees in exchange for their interests in JMP Credit. As a result of the aforementioned transfer, we own approximately 94% of the subordinated notes of CLO I.

On April 30, 2013, entities sponsored by JMP Group Inc. closed on a \$343.8 million CLO. The senior notes offered in this transaction (the “Secured Notes”) were issued by CLO II, a special purpose Cayman vehicle, and co-issued in part by JMP Credit Advisors CLO II LLC, a special purpose Delaware vehicle, and were backed by a diversified portfolio of broadly syndicated leveraged loans. The Company, through a wholly-owned subsidiary, manages CLO II and owns \$17.3 million, or 73%, of the subordinated notes of the Issuer (the “Subordinated Notes”).

HCC LLC launched on August 18, 2011 to make direct investments in the form of subordinated debt and, to a lesser extent, senior debt and minority equity investments, in privately-held U.S. small to mid-size companies. The Company and affiliates owned approximately 59% of HCC LLC at December 31, 2012. The Company consolidated HCC LLC into its consolidated financial statements. In 2013, the outstanding limited liability company units of HCC LLC were converted into a number of shares of HCC common stock. On May 2, 2013, HCC priced its initial public offering, which reduced the Company's ownership of HCC to 11.6%. At such date, the Company no longer consolidated HCC.

HCAP Advisors was formed on December 18, 2012. HCAP Advisors appointed JMP Group LLC as its Manager effective May 1, 2013, and began offering investment advisory services. The Company owns 51% equity interest in the entity.

**Historical Results of Operations**

The following table sets forth our historical results of operations for the years ended December 31, 2013, 2012 and 2011 and is not necessarily indicative of the results to be expected for any future period.

| <i>(In thousands)</i>                              | <b>Year Ended December 31,</b> |             |             | <b>Change from</b>  |          | <b>Change from</b>  |          |  |  |
|--|--------------------------------|-------------|-------------|---------------------|----------|---------------------|----------|--|--|
|  | <b>2013</b>                    | <b>2012</b> | <b>2011</b> | <b>2012 to 2013</b> |          | <b>2011 to 2012</b> |          |  |  |
|  |                                |             |             | <b>\$</b>           | <b>%</b> | <b>\$</b>           | <b>%</b> |  |  |
| Revenues   |                                |             |             |                     |          |                     |          |  |  |
| Investment banking                                 | \$74,173                       | \$50,982    | \$46,114    | \$23,191            | 45.5 %   | \$4,868             | 10.6 %   |  |  |
| Brokerage  | 24,625                         | 21,903      | 25,461      | 2,722               | 12.4 %   | (3,558 )            | -14.0 %  |  |  |
| Asset management fees                              | 25,952                         | 15,775      | 19,785      | 10,177              | 64.5 %   | (4,010 )            | -20.3 %  |  |  |
| Principal transactions                             | 20,727                         | 10,537      | 1,615       | 10,190              | 96.7 %   | 8,922               | 552.4 %  |  |  |
| Gain on sale, payoff and mark-to-market of loans   | 1,806                          | 7,255       | 16,997      | (5,449 )            | -75.1 %  | (9,742 )            | -57.3 %  |  |  |
| Net dividend income                                | 535                            | (29 )       | 1,365       | 564                 | 1944.8 % | (1,394 )            | -102.1 % |  |  |
| Other income                                       | 798                            | 3,800       | 4,336       | (3,002 )            | -79.0 %  | (536 )              | -12.4 %  |  |  |
| Non-interest revenues                              | 148,616                        | 110,223     | 115,673     | 38,393              | 34.8 %   | (5,450 )            | -4.7 %   |  |  |
| Interest income                                    | 33,346                         | 32,898      | 33,356      | 448                 | 1.4 %    | (458 )              | -1.4 %   |  |  |
| Interest expense                                   | (30,110 )                      | (39,993 )   | (35,747 )   | 9,883               | -24.7 %  | (4,246 )            | 11.9 %   |  |  |
| Net interest (expense) income                      | 3,236                          | (7,095 )    | (2,391 )    | 10,331              | 145.6 %  | (4,704 )            | -196.7 % |  |  |
| Provision for loan losses                          | (2,637 )                       | (2,206 )    | (1,728 )    | (431 )              | 19.5 %   | (478 )              | 27.7 %   |  |  |
| Total net revenues after provision for loan losses | 149,215                        | 100,922     | 111,554     | 48,293              | 47.9 %   | (10,632 )           | -9.5 %   |  |  |
| Non-interest expenses                              |                                |             |             |                     |          |                     |          |  |  |
| Compensation and benefits                          | 102,432                        | 66,415      | 89,017      | 36,017              | 54.2 %   | (22,602 )           | -25.4 %  |  |  |
| Administration                                     | 8,660                          | 6,186       | 6,649       | 2,474               | 40.0 %   | (463 )              | -7.0 %   |  |  |
| Brokerage, clearing and exchange fees              | 3,543                          | 3,806       | 4,735       | (263 )              | -6.9 %   | (929 )              | -19.6 %  |  |  |
| Travel and business development                    | 4,416                          | 3,387       | 3,681       | 1,029               | 30.4 %   | (294 )              | -8.0 %   |  |  |
| Communication and technology                       | 3,534                          | 3,503       | 3,988       | 31                  | 0.9 %    | (485 )              | -12.2 %  |  |  |
| Professional fees                                  | 3,953                          | 3,630       | 2,955       | 323                 | 8.9 %    | 675                 | 22.8 %   |  |  |
| Impairment loss on purchased management contract   | -                              | -           | 700         | -                   | N/A      | (700 )              | -100.0 % |  |  |
| Other  | 5,126                          | 4,461       | 4,074       | 665                 | 14.9 %   | 387                 | 9.5 %    |  |  |
| Total non-interest expenses                        | 131,664                        | 91,388      | 115,799     | 40,276              | 44.1 %   | (24,411 )           | -21.1 %  |  |  |
| Income (loss) before income tax expense            | 17,551                         | 9,534       | (4,245 )    | 8,017               | 84.1 %   | 13,779              | 324.6 %  |  |  |

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|  |         |         |            |       |         |         |         |
|--|---------|---------|------------|-------|---------|---------|---------|
| Income tax expense (benefit)                                     | 3,950   | 1,581   | (1,632 )   | 2,369 | 149.8 % | 3,213   | 196.9 % |
| Net income (loss)  | 13,601  | 7,953   | (2,613 )   | 5,648 | 71.0 %  | 10,566  | 404.4 % |
| Less: Net income (loss) attributable to non-controlling interest | 9,973   | 5,196   | (157 )     | 4,777 | 91.9 %  | 5,353   | 3409.6% |
| Net income (loss) attributable to JMP Group Inc.                 | \$3,628 | \$2,757 | \$(2,456 ) | \$871 | 31.6 %  | \$5,213 | 212.3 % |

## Overview

### **Year Ended December 31, 2013, Compared to Year Ended December 31, 2012**

Total net revenues after provision for loan losses increased \$48.3 million, or 47.9%, from \$100.9 million for the year ended December 31, 2012 to \$149.2 million for the year ended December 31, 2013, resulting from an increase in total non-interest revenues of \$38.4 million, and an increase in net interest income of \$10.3 million, partially offset by an increase in provision for loan losses of \$0.4 million.

Total non-interest revenues increased \$38.4 million, or 34.8%, primarily due to increases in investment banking revenues of \$23.2 million, an increase of asset management fees of \$10.2 million, an increase of principal transactions of \$10.2 million, partially offset by a decrease in gain on sale, payoff and mark-to-market of loans of \$5.5 million.

Net interest income increased \$10.3 million, or 145.6%, from net interest income expense of \$7.1 million for the year ended December 31, 2012 to net interest income of \$3.2 million for the same period in 2013. This increase in net interest income is primarily attributed to an increase in net interest earned at JMP Credit, partially offset by \$3.6 million net interest expense related to the bond issued in January 2013.

Total non-interest expenses increased \$40.3 million, or 44.1%, from \$91.4 million for the year ended December 31, 2012 to \$131.7 million for the year ended December 31, 2013, primarily due to an increase in compensation and benefits of \$36.0 million.

Net income attributable to JMP Group Inc. increased \$0.9 million, or 31.6%, from \$2.8 million for the year ended December 31, 2012 to \$3.6 million for the year ended December 31, 2013 and includes income tax expense of \$1.6 million and \$4.0 million for the years ended December 31, 2012 and 2013, respectively.

### **Year Ended December 31, 2012, Compared to Year Ended December 31, 2011**

Total net revenues after provision for loan losses decreased \$10.7 million, or 9.5%, from \$111.6 million for the year ended December 31, 2011 to \$100.9 million for the year ended December 31, 2012, resulting from a decrease in total

non-interest revenues of \$5.5 million, and a decrease in net interest income of \$4.7 million, and an increase in provision for loan losses of \$0.5 million.

Total non-interest revenues decreased \$5.5 million, or 4.7%, primarily due to a decrease in gain on sale, payoff and mark-to-market of loans of \$9.7 million, a decrease of asset management fees of \$4.0 million, and a decrease of brokerage revenues of \$3.6 million, partially offset by an increase in principal transaction revenues of \$8.9 million and an increase in investment banking revenues of \$4.9 million.

Net interest expense increased \$4.7 million, or 196.7%, from \$2.4 million for the year ended December 31, 2011 to \$7.1 million for the same period in 2012. The increase was primarily due to an increase in net amortization of liquidity discounts at JMP Credit of \$7.7 million, from a \$21.5 million loss for the year ended December 31, 2011 to a \$29.2 million loss for the year ended December 31, 2012.

Total non-interest expenses decreased \$24.4 million, or 21.1%, from \$115.8 million for the year ended December 31, 2011 to \$91.4 million for the year ended December 31, 2012, primarily due to a decrease in compensation and benefits of \$22.6 million.

Net income attributable to JMP Group Inc. increased \$5.2 million, or 212.3%, from a \$2.5 million loss for the year ended December 31, 2011 to \$2.8 million for the year ended December 31, 2012 and includes an income tax benefit of \$1.6 million and tax expense of \$1.6 million for the years ended December 31, 2011 and 2012, respectively.

### **Adjusted Operating Net Income (Non-GAAP Financial Measure)**

Management uses Adjusted Operating Net Income as a key, non-GAAP metric when evaluating the performance of JMP Group's core business strategy and ongoing operations, as management believes that this metric appropriately illustrates the operating results of JMP Group's core operations and business activities. Adjusted Operating Net Income is derived from our segment reported results and is the measure of segment profitability on an after-tax basis used by management to evaluate our performance. This non-GAAP measure is presented to enhance investors' overall understanding of our current financial performance. Additionally, management believes that Adjusted Operating Net Income is a useful measure because it allows for a better evaluation of the performance of JMP Group's ongoing business and facilitates a meaningful comparison of the company's results in a given period to those in prior and future periods. Moreover, the company utilized Adjusted Operating Net Income as a threshold for the vesting of performance-related RSUs granted as a component of 2011 and 2012 employee bonus compensation.

However, Adjusted Operating Net Income should not be considered a substitute for results that are presented in a manner consistent with GAAP. A limitation of the non-GAAP financial measures presented is that, unless otherwise indicated, the adjustments concern gains, losses or expenses that JMP Group generally expects to continue to

recognize, and the adjustment of these items should not always be construed as an inference that these gains or expenses are unusual, infrequent or non-recurring. Therefore, management believes that both JMP Group's GAAP measures of its financial performance and the respective non-GAAP measures should be considered together. Adjusted Operating Net Income may not be comparable to a similarly titled measure presented by other companies.



Adjusted Operating Net Income is a non-GAAP financial measure that adjusts the Company's GAAP net income as follows:

- (i) reverses non-cash stock-based compensation expense recognized under GAAP related to historical equity awards granted in prior periods (both at the time of JMP Group's May 2007 initial public offering and thereafter), as management generally evaluates performance by considering the full expense of equity awards granted in the period in which such compensation was awarded, even if the expense of that award will be recognized in future periods under GAAP;
- (ii) recognizes 100% of the cost of deferred compensation, including non-cash stock-based compensation expense, in the period for which such compensation was awarded, instead of recognizing such cost over the vesting period as required under GAAP, in order to match compensation expense with the actual period upon which the compensation was based;
- (iii) excludes the non-cash net amortization of liquidity discounts on loans held and asset-backed securities issued by JMP Credit Corporation, due to scheduled contractual principal repayments, which is not representative of the Company's core operating results or core business activities;
- (iv) excludes non-cash amortization expense related to an intangible asset;
- (v) reverses net non-cash unrealized gains and losses on strategic equity investments and warrants;
- (vi) excludes non-cash unrealized mark-to-market gains or losses on the investment portfolio at HCC, due to its adoption of investment company accounting in preparation for its pending initial public offering as a business development company;
- (vii) accelerates recognition of a non-recurring expense of \$450,000 in 2012 which was incurred in connection with the initial public offering of HCC on May 2, 2013;
- (viii) excludes non-cash gains or losses recognized by JMP Credit Corporation due to the sale or payoff of loans originally included in the portfolio acquired by JMP Group in April 2009, as these gains and losses provide a relatively volatile revenue stream that management believes is not indicative of the Company's core businesses and ongoing operations;
- (ix) presents revenues and expenses on a basis that deconsolidates HGC, HGC II and HCC LLC. HGC and HGC II are investment funds that HCS manages; we own a relatively small percentage of these funds, even though they are consolidated under GAAP;
- (x) excludes general loan loss reserves on CLO II; and
- (xi) assumes a combined federal, state and local income tax rate of 38% for the year ended December 31, 2013, and 42% for all prior periods.

Discussed below is our adjusted operating net income by segment. This information is reflected in a manner utilized by management to assess the financial operations of the Company's various business lines.

## Year Ended December 31, 2013

| <i>(In thousands)</i>                            | Broker-Dealer | Asset Management | Corporate Credit | Operating Platforms | Investment Income | Corporate Costs | Eliminations | Total Segments |
|--|---------------|------------------|------------------|---------------------|-------------------|-----------------|--------------|----------------|
| Revenues   |               |                  |                  |                     |                   |                 |              |                |
| Investment banking                               | \$74,508      | \$ -             | \$ -             | \$74,508            | \$ -              | \$ -            | \$ (335 )    | \$74,173       |
| Brokerage  | 24,625        | -                | -                | 24,625              | -                 | -               | -            | 24,625         |
| Asset management related fees                    | -             | 29,598           | 4,735            | 34,333              | -                 | -               | (5,429 )     | 28,904         |
| Principal transactions                           | -             | -                | -                | -                   | 8,180             | -               | -            | 8,180          |
| Gain on sale, payoff and mark-to-market of loans | -             | -                | -                | -                   | 1,735             | -               | -            | 1,735          |
| Net dividend income                              | -             | -                | -                | -                   | 1,213             | -               | -            | 1,213          |
| Net interest income                              | -             | -                | -                | -                   | 16,470            | -               | -            | 16,470         |
| Provision for loan losses                        | -             | -                | -                | -                   | (51 )             | -               | -            | (51 )          |
| Adjusted net revenues                            | 99,133        | 29,598           | 4,735            | 133,466             | 27,547            | -               | (5,764 )     | 155,249        |
| Non-interest expenses                            |               |                  |                  |                     |                   |                 |              |                |
| Non-interest expenses                            | 84,785        | 29,628           | 3,691            | 118,104             | 5,224             | 16,039          | (5,744 )     | 133,623        |
| Less: Non-controlling interest                   | -             | (1)              | (1,732 )         | (1,732)             | 981               | -               | -            | (751 )         |
| Operating pre-tax net income                     | 14,348        | 1,702            | 1,044            | 17,094              | 21,342            | (16,039 )       | (20 )        | 22,377         |
| Income tax expense (assumed rate of 38%)         | 5,452         | 646              | 397              | 6,495               | 8,110             | (6,095 )        | (8 )         | 8,502          |
| Adjusted operating net income (loss)             | \$8,896       | \$ 1,056         | \$ 647           | \$10,599            | \$13,232          | \$ (9,944 )     | \$ (12 )     | \$13,875       |

(1) HCAP Advisors' non-controlling interest.

## Year Ended December 31, 2012

| <i>(In thousands)</i> | Broker-Dealer | Asset Management | Corporate Credit | Operating Platforms | Investment Income | Corporate Costs | Eliminations | Total Segments |
|-----------------------|---------------|------------------|------------------|---------------------|-------------------|-----------------|--------------|----------------|
| Revenues              |               |                  |                  |                     |                   |                 |              |                |
| Investment banking    | \$51,174      | \$ -             | \$ -             | \$51,174            | \$ -              | \$ -            | \$ -         | \$51,174       |
| Brokerage             | 21,903        | -                | -                | 21,903              | -                 | -               | -            | 21,903         |
|                       | 53            | 23,177           | 4,064            | 27,294              | -                 | -               | (5,419 )     | 21,875         |

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|  |         |          |        |         |           |            |          |           |
|--|---------|----------|--------|---------|-----------|------------|----------|-----------|
| Asset management related fees                    |         |          |        |         |           |            |          |           |
| Principal transactions                           | -       | -        | -      | -       | 6,320     | -          | -        | 6,320     |
| Gain on sale, payoff and mark-to-market of loans | -       | -        | -      | -       | 1,916     | -          | -        | 1,916     |
| Net dividend income                              | -       | -        | -      | -       | 206       | -          | -        | 206       |
| Net interest income                              | -       | -        | -      | -       | 19,313    | -          | -        | 19,313    |
| Provision for loan losses                        | -       | -        | -      | -       | (184 )    | -          | -        | (184 )    |
| Adjusted net revenues                            | 73,130  | 23,177   | 4,064  | 100,371 | 27,571    | -          | (5,419 ) | 122,523   |
| Non-interest expenses                            |         |          |        |         |           |            |          |           |
| Non-interest expenses                            | 67,152  | 20,686   | 2,996  | 90,834  | (4,130 )  | 13,647     | (5,419 ) | 94,932    |
| Less: Non-controlling interest                   | -       | -        | -      | -       | 670       | -          | -        | 670       |
| Operating pre-tax net income                     | 5,978   | 2,491    | 1,068  | 9,537   | 31,031    | (13,647 )  | -        | 26,921    |
| Income tax expense (assumed rate of 42%)         | 2,511   | 1,046    | 449    | 4,006   | 13,033    | (5,732 )   | -        | 11,307    |
| Adjusted operating net income (loss)             | \$3,467 | \$ 1,445 | \$ 619 | \$5,531 | \$ 17,998 | \$(7,915 ) | \$ -     | \$ 15,614 |

| <i>(In thousands)</i>                            | Year Ended December 31, 2011 |                  |                  |                     |                   |                 |              | Total Segments |
|--|------------------------------|------------------|------------------|---------------------|-------------------|-----------------|--------------|----------------|
|  | Broker-Dealer                | Asset Management | Corporate Credit | Operating Platforms | Investment Income | Corporate Costs | Eliminations |                |
| Revenues   |                              |                  |                  |                     |                   |                 |              |                |
| Investment banking                               | \$46,135                     | \$ -             | \$ -             | \$46,135            | -                 | \$-             | \$ (21 )     | \$46,114       |
| Brokerage  | 25,461                       | -                | -                | 25,461              | -                 | -               | -            | 25,461         |
| Asset management related fees                    | 142                          | 23,812           | 6,013            | 29,967              | -                 | -               | (5,086 )     | 24,881         |
| Principal transactions                           | -                            | -                | -                | -                   | 1,080             | -               | -            | 1,080          |
| Gain on sale, payoff and mark-to-market of loans | -                            | -                | -                | -                   | 2,224             | -               | -            | 2,224          |
| Net dividend income                              | -                            | -                | -                | -                   | 1,365             | -               | -            | 1,365          |
| Net interest (expense) income                    | -                            | -                | -                | -                   | 21,332            | -               | -            | 21,332         |
| Provision for loan losses                        | -                            | -                | -                | -                   | (35 )             | -               | -            | (35 )          |
| Adjusted net revenues                            | 71,738                       | 23,812           | 6,013            | 101,563             | 25,966            | -               | (5,107 )     | 122,422        |
| Non-interest expenses                            |                              |                  |                  |                     |                   |                 |              |                |
| Non-interest expenses                            | 68,853                       | 20,254           | 4,585            | 93,692              | 112               | 11,460          | (5,086 )     | 100,178        |
| Less: Non-controlling interest                   | -                            | -                | -                | -                   | 590               | -               | -            | 590            |
| Operating pre-tax net income                     | 2,885                        | 3,558            | 1,428            | 7,871               | 25,264            | (11,460 )       | (21 )        | 21,654         |
| Income tax expense (assumed rate of 42%)         | 1,212                        | 1,494            | 600              | 3,306               | 10,611            | (4,814 )        | (9 )         | 9,094          |
| Adjusted operating net income                    | \$1,673                      | \$2,064          | \$828            | \$4,565             | \$14,653          | \$(6,646 )      | \$(12 )      | \$12,560       |

The following table reconciles the adjusted operating net income to Total Segments adjusted operating pre-tax net income, to consolidated pre-tax net income (loss) attributable to JMP Group, and to consolidated net income (loss) attributable to JMP Group, for the years ended December 31, 2011, 2012 and 2013.

| <i>(In thousands)</i>  | Year Ended December 31, |          |          |
|--|-------------------------|----------|----------|
|  | 2013                    | 2012     | 2011     |
| <b>Adjusted operating net income</b>   | \$13,875                | \$15,614 | \$12,560 |
| Addback of Income tax expense (assumed rate of 38% for 2013 and 42% for prior years) | 8,502                   | 11,307   | 9,094    |
| <b>Total Segments adjusted operating pre-tax net income</b>                          | \$22,377                | \$26,921 | \$21,654 |
| Subtract / (Add back)  |                         |          |          |

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|   |                |                |                   |
|---|----------------|----------------|-------------------|
| Stock options / IPO RSU expense   | 920            | -              | 778               |
| Compensation expense - post-IPO RSUs  | 2,823          | 2,492          | 9,526             |
| Deferred compensation program accounting adjustment                                 | (6,170 )       | (6,985 )       | -                 |
| HCC IPO administrative expense  | 450            | (450 )         | -                 |
| Net unrealized loss/ (gain) on strategic equity investments and warrants.           | (596 )         | 527            | (441 )            |
| General loan loss reserve for CLO II  | 1,241          | -              | -                 |
| Net amortization of liquidity discounts on loans and asset-backed securities issued | 14,979         | 29,208         | 23,522            |
| Amortization of intangible asset  | -              | -              | 200               |
| Unrealized mark-to-market (gain)/loss - HCC   | 610            | (627 )         | 17                |
| Gain on loan portfolio acquired   | 542            | (1,582 )       | (7,860 )          |
| <b>Consolidated pre-tax net income (loss) attributable to JMP Group Inc.</b>        | <b>\$7,578</b> | <b>\$4,338</b> | <b>\$(4,088 )</b> |
| Income tax expense (benefit)  | 3,950          | 1,581          | (1,632 )          |
| <b>Consolidated Net Income (Loss) attributable to JMP Group Inc.</b>                | <b>\$3,628</b> | <b>\$2,757</b> | <b>\$(2,456 )</b> |

When evaluating the performance of JMP Group's core business strategy and ongoing operations, management also reviews the Operating Net Income which includes the non-cash gains and losses recognized by JMP Credit Corp due to the sale or payoff of loans originally included in the portfolio acquired by JMP Group in April 2009, as well as the provision for loan losses related to this portfolio of loans. The reconciling items are included in the line item gain (loss) and specific provisions on loan portfolio acquired in the table above. Including these adjustments, the operating net income, after a 38%, 42% and 42% tax rate, is \$4.6 million, \$0.9 million and \$0.3 million for the years ended December 31, 2011, 2012 and 2013, respectively.

## **Year Ended December 31, 2013, Compared to Year Ended December 31, 2012**

### **Revenues**

#### *Investment Banking*

Investment banking revenues increased \$23.2 million, or 45.5%, from \$51.0 million for the year ended December 31, 2012 to \$74.2 million for the same period in 2013. As a percentage of total net revenues after provision for loan losses, investment banking revenues decreased from 50.5% for the year ended December 31, 2012 to 49.7% for the year ended December 31, 2013.

Our segment reported investment banking revenues, primarily earned in our Broker-Dealer segment, increased \$23.0 million, or 47.8%, from \$51.2 million for the year ended December 31, 2012 to \$74.2 million for the same period in 2013. The increase primarily resulted from 39.0% more deals from prior year, in addition to a 4.6% increase in average revenue per deal. Private capital market and other revenues decreased \$5.7 million, from \$10.2 million for the year ended December 31, 2012 to \$4.5 million for the year ended December 31, 2013. We executed 12 private placement transactions in 2012 compared to four in 2013. Public equity underwriting revenues increased \$10.8 million, or 37.3%, from \$29.0 million for the year ended December 31, 2012 to \$39.8 million for the year ended December 31, 2013. We executed 82 public equity underwriting transactions in 2012 compared to 123 in 2013. We acted as a lead manager on 17 transactions in 2012 and 30 in 2013. Our debt and convertible revenues increased \$15.7 million, or 503.6%, from \$3.1 million for the year ended December 31, 2012 to \$18.8 million for the year ended December 31, 2013. We executed 18 debt and convertible transactions in 2012 compared to 32 in the same period in 2013. Our strategic advisory revenues increased \$2.3 million, or 25.4%, from \$8.9 million for the year ended December 31, 2012 to \$11.1 million for the year ended December 31, 2013, due to larger transactions. We executed 12 strategic advisory transactions in both 2012 and 2013. As a percentage of total adjusted net revenues, investment banking revenues increased from 41.8% for the year ended December 31, 2012 to 47.8% for the year ended December 31, 2013.

#### *Brokerage Revenues*

Brokerage revenues earned in our Broker-Dealer segment increased \$2.7 million, or 12.4%, from \$21.9 million for the year ended December 31, 2012 to \$24.6 million for the year ended December 31, 2013. The increase was primarily the result of increased trading volume. Brokerage revenues decreased as a percentage of total net revenues after provision for loan losses, from 21.7% for the year ended December 31, 2012 to 16.5% for the year ended December 31, 2013. On an adjusted basis, brokerage revenues decreased from 17.9% for the year ended December 31, 2012 to 15.9% for the year ended December 31, 2013 as a percentage of adjusted net revenue after provision for loan losses.

*Asset Management Related Fees*

| <i>(In thousands)</i>                               | <b>Year Ended</b>   |                     |
|---|---------------------|---------------------|
|   | <b>December 31,</b> | <b>December 31,</b> |
|   | <b>2013</b>         | <b>2012</b>         |
| Base management fees:                               |                     |                     |
| Fees reported as asset management fees              | \$10,813            | \$9,433             |
| Fees reported as other income                       | 695                 | 1,956               |
| Fees earned at HGC, HGC II and HCC LLC              | 1,738               | 1,112               |
| Total base management fees                          | 13,246              | 12,501              |
| Incentive fees:                                     |                     |                     |
| Fees reported as asset management fees              | \$15,139            | \$6,342             |
| Fees reported as other income                       | -                   | -                   |
| Fees earned at HGC, HGC II and HCC LLC              | 417                 | 1,188               |
| Total incentive fees                                | 15,556              | 7,530               |
| Other fee income:                                   |                     |                     |
| Fundraising fees                                    | \$103               | \$109               |
| New York Mortgage Trust termination fee             | 0                   | 1,735               |
| Total other fee income                              | 103                 | 1,844               |
| Asset management related fees:                      |                     |                     |
| Fees reported as asset management fees              | \$25,952            | \$15,775            |
| Fees reported as other income                       | 798                 | 3,800               |
| Fees earned at HGC, HGC II and HCC LLC              | 2,155               | 2,300               |
| Total Segment asset management related fee revenues | \$28,905            | \$21,875            |
| Consolidation adjustment                            | (2,155 )            | (2,300 )            |
| Adjusted total asset management related fees:       | \$26,750            | \$19,575            |

Fees reported as asset management fees increased \$10.2 million, or 64.5%, from \$15.8 million for the year ended December 31, 2012 to \$26.0 million for the year ended December 31, 2013. As a percentage of total net revenues after provision for loan losses, asset management revenues increased from 15.6% for the year ended December 31, 2012 to 17.4% for the year ended December 31, 2013. Fees reported as other income decreased \$3.0 million, or 79.0% from \$3.8 million for the year ended December 31, 2012 to \$0.8 million for the year ended December 31, 2013. As a percentage of total net revenues after provision for loan losses, other income decreased from 3.8% for the year ended December 31, 2012 to 0.5% for the same period in 2013.



Total segment asset management related fees include base management fees and incentive fees for our funds and CLOs under management, as well as other income from fee sharing arrangements with, and fees earned to raise capital for, third-party investment partnerships or funds. Adjusted asset management related fees is a non-GAAP financial measure that adjusts our total segment asset management related fees by reversing the elimination of those fees in the consolidation of HGC, HGC II and HCC LLC (through May 1, 2013). Adjusted asset management related fees are reconciled to the GAAP measure, total segment asset management fee revenues, in the table above. We believe that presenting adjusted asset management related fees is useful to investors as a means of assessing the performance of JMP Group's combined asset management activities, including its fundraising and other services for third parties. We believe that adjusted asset management-related fee revenues provides useful information by indicating the relative contributions of base management fees and performance-related incentive fees, thus facilitating a comparison of those fees in a given period to those in prior and future periods. We also believe that asset management-related fee revenue is a more meaningful measure than standalone asset management fees as reported, because asset management-related fee revenues represent the combined impact of JMP Group's various asset management activities on the Company's total net revenues.

Total segment asset management related fee revenue increased \$7.0 million from \$21.9 million for the year ended December 31, 2012 to \$28.9 million for the year ended December 31, 2013. The increase was attributed to increases in base management fees and incentive fees, partially offset by an increase in other fee income. Base management fees were \$12.5 million and \$13.2 million for the years ended December 31, 2012 and 2013, respectively. Base management fees reported as asset management fees increased \$1.4 million from \$9.4 million for the year ended December 31, 2012 to \$10.8 million for the year ended December 31, 2013, and was driven by the increases of \$0.5 million related to Harvest Opportunity Partners ("HOP II"), \$0.3 million related to Harvest Technology Partners ("HTP"), \$0.3 million related to Harvest Franchise Fund ("HFF"), partially offset by the reduction of \$0.8 million fees related to Harvest Diversified Partners ("HDP"). Base management fees reported as other income decreased \$1.3 million from \$2.0 million to \$0.7 million, driven by a \$0.8 million management fee received in 2012 due to expiration of certain revenue sharing arrangements. Total incentive fees increased \$8.0 million from \$7.5 million for the year ended December 31, 2012 to \$15.6 million for the same period in 2013. The increase in incentive fees was driven by an increase of \$5.2 million related to Harvest Small Cap Partners ("HSCP") and an increase of \$3.2 million related to HFF. Other income decreased \$1.7 million, resulting from the termination fee received in 2012 associated with the December 31, 2011 termination of our advisory agreement with NYMT. On an adjusted basis, adjusted asset management related fees increased from 17.9% for the year ended December 31, 2012 to 18.6% for the year ended December 31, 2013 as a percentage of adjusted net revenues after provision for loan losses.

#### *Principal Transactions*

Principal transaction revenues increased \$10.2 million from \$10.5 million for the year ended December 31, 2012 to \$20.7 million for the same period in 2013. As a percentage of total net revenues after provision for loan losses, principal transaction revenues increased from 10.4% for the year ended December 31, 2012 to 13.9% for the year ended December 31, 2013.

Total segment principal transaction revenues increased \$1.9 million from \$6.3 million for the year ended December 31, 2012 to \$8.2 million for the same period in 2013. Total segment principal transaction revenue is a non-GAAP financial measure that aggregates our segment reported principal transaction revenues across each segment. We believe that presenting total segment principal transaction revenues is useful to investors as a means of assessing the performance of JMP Group's combined investment activities. The principal transaction revenues for both 2012 and 2013 were based entirely in our Investment Income segment. Total segment principal transaction revenues are reconciled to the GAAP measure, total principal transaction revenues, in the table below.

| <i>(In thousands)</i>   | <b>Year Ended</b>            |             |
|---|------------------------------|-------------|
|   | <b>December 31,<br/>2013</b> | <b>2012</b> |
| Equity and other securities excluding non-controlling interest            | \$2,301                      | \$2,704     |
| Warrants and other investments  | 1,706                        | 577         |
| Investment partnerships   | 4,173                        | 3,039       |
| Total Segment principal transaction revenues                              | 8,180                        | 6,320       |
| Operating adjustment addbacks   | 249                          | 1,102       |
| Non-controlling interest in HGC, HGC II and HCC LLC (through May 2, 2013) | 12,297                       | 3,115       |
| Total principal transaction revenues                                      | \$20,726                     | \$10,537    |

The increase reflects higher revenue from our warrants and other investments and investment partnerships, partially offset by a decrease in equity investment and other securities. Revenues from warrants and other investments increased by \$1.1 million from \$0.6 million for the year ended December 31, 2012 to revenues of \$1.7 million for the year ended December 31, 2013. The increase was primarily related to \$1.4 million increase in our investment in a private equity fund managed by a third party which invests in the growth technology sector and \$0.6 million increase related to one of our warrants. These increases were partially offset by a \$0.8 million gain in redemptions from Class D Preferred Units of Sanctuary Wealth Services LLC ("Sanctuary") during 2012. Revenues from our investment partnerships increased \$1.2 million from \$3.0 million for the year ended December 31, 2012 to \$4.2 million for the year ended December 31, 2013, driven by \$0.8 million increase related to HFF and \$0.6 million related to HAS. Revenues from equity and other securities decreased \$0.4 million from \$2.7 million for the year ended December 31, 2012 to \$2.3 million for the same period in 2013, primarily due to lower gain earned on our principal investment portfolio. On an adjusted basis, as a percentage of total net revenues after provision for loan losses, principal transaction revenues increased from 5.2% for the year ended December 31, 2012 to 5.3% for the year ended December 31, 2013.

*Gain on Sale, Payoff and Mark-to-market of Loans*

Gain on sale, payoff and mark-to-market of loans decreased \$5.4 million, or 75.1%, from \$7.3 million for the year ended December 31, 2012 to \$1.8 million for the same period in 2013, with \$1.7 million of the gain generated at JMP Credit and \$0.1 million generated at HCC LLC. At JMP Credit, during the year ended December 31, 2013, 168 loans were sold or paid off, resulting in a total net gain of \$2.1 million. Of the total net gain, \$1.3 million was related to 91 loan payoffs, where the borrowers repaid the loans at a premium to our carrying value. The remaining \$0.8 million related to 77 loans, 27 of which were sold at a discount to our carrying value, 44 of which were sold at par, which was a premium to our carrying value and six of which were related to terminations of unfunded lines of credit. While we expect further gains from loan payoffs and sales in future periods, these revenues are highly unpredictable as we are not actively marketing the loans collateralized by asset-backed securities for sale. As a percentage of total net revenues after provision for loan losses, gain on sale, payoff and mark-to-market of loans decreased from 7.2% for the year ended December 31, 2012 to 1.2% for the year ended December 31, 2013.

Gain on sale, payoff and mark-to-market of loans was earned in our Investment Income segment. On a segment reporting basis, the gain on sale, payoff and mark-to-market of loans in our Investment Income segment excludes the financial impact of gains or losses due to the sale or payoff of loans originally included in the CLO I portfolio acquired by JMP Group in April 2009. The segment reported gain on sale, payoff and mark-to-market of loans also excludes unrealized mark-to-market gains or losses on the investment portfolio at HCC LLC. Our segment reported gain on sale, payoff and mark-to-market of loans in the Investment Income segment decreased \$0.2 million, or from \$1.9 million for the year ended December 31, 2012 to \$1.7 million for the year ended December 31, 2013. Gain on sale, payoff and mark-to-market of loans decreased from 1.6% for the year ended December 31, 2012 to 1.1% for the year ended December 31, 2013 as a percentage of total segment adjusted net revenues.

*Net Dividend Income*

Net dividend income increased from a \$29 thousand loss for the year ended December 31, 2012 to \$0.5 million for the same period in 2013, primarily related to dividends from our HCC investment. Dividends earned on our investment in HCC LLC were eliminated in consolidation prior to May 2, 2013.

Our net dividend income was earned in our Investment Income segment. On a segment reporting basis, net dividend income increased from \$0.2 million to \$1.2 million for the years ended December 31, 2012 and 2013, respectively, and primarily comprised of dividends from our investment in HCC LLC and HCC.

As a percentage of total segment adjusted net revenues, net dividend income increased from 0.2% for the year ended December 31, 2012 to 0.8% for the year ended December 31, 2013.

*Net Interest Income (Expense)*

| <i>(In thousands)</i>                          | <b>Year Ended</b>   |             |
|--|---------------------|-------------|
|  | <b>December 31,</b> |             |
|  | <b>2013</b>         | <b>2012</b> |
| CLO I loan contractual interest income         | \$18,233            | \$21,547    |
| CLO I ABS issued contractual interest expense  | (4,390 )            | (5,202 )    |
| Net CLO I contractual interest                 | 13,843              | 16,345      |
| CLO II loan contractual interest income        | \$8,341             | \$-         |
| CLO II ABS issued contractual interest expense | (4,841 )            | -           |
| Net CLO II contractual interest                | 3,500               | -           |
| Bond Payable interest expense                  | (3,610 )            | -           |
| Other interest income                          | 2,737               | 2,968       |
| Total Segment net interest income              | \$16,470            | \$19,313    |
| CLO I loan liquidity discount accretion        | 569                 | 4,691       |
| CLO I ABS liquidity discount amortization      | (15,548)            | (33,899)    |
| Net CLO I liquidity discount amortization      | (14,979)            | (29,208)    |
| HCC LLC interest income                        | 2,393               | 3,774       |
| HCC LLC interest expense                       | (630 )              | (974 )      |
| Net HCC LLC interest income                    | 1,763               | 2,800       |
| Total net interest expense                     | \$3,254             | \$(7,095 )  |

Net interest income increased \$10.3 million, or 145.6% from interest expense of \$7.1 million for the year ended December 31, 2012 to income of \$3.2 million for the year ended December 31, 2013. Net interest expense included liquidity discount amortization of \$29.2 million and \$14.9 million for the years ended December 31, 2012 and December 31, 2013, respectively. Net interest income also included bond payable interest expense of \$3.6 million for the year ended December 31, 2013. As a percentage of total net revenues after provision for loan losses, net interest expense decreased from 7.0% for the year ended December 31, 2012 to 2.2% for the year ended December 31, 2013.

Total segment net interest income decreased from \$19.3 million for the year ended December 31, 2012 to \$16.5 million for the year ended December 31, 2013. Our total segment net interest income excludes net amortization of liquidity discounts on loans and asset-backed securities issued. Net interest income is earned primarily in our JMP Credit segment, and largely reflects net CLO contractual interest. Total segment net interest income is a non-GAAP financial measure that aggregates our segment reported net interest income (expense) across each segment. We believe that presenting total segment net interest income is useful to investors as a means of assessing the performance of JMP Group's combined credit activities. Total segment net interest income is reconciled to the GAAP measure, total net interest expense, in the table above. As a percentage of total segment adjusted net revenues, net interest income decreased from 15.8% for the year ended December 31, 2012 to 10.6% for the year ended December 31, 2013.

The following table sets forth contractual interest income and expense related to CLO loans and ABS issued and their weighted average contractual interest rates:

(In thousands)

|  | Year Ended December 31, 2013 |   |  |                        |                                  |   |  |  |
|--|------------------------------|---|--|------------------------|----------------------------------|---|--|--|
|  | Interest Income (Expense)    | Average CLO Loan (CLO ABS Issued) Balance | Weighted Average Contractual Interest Rate | Weighted Average LIBOR | Spread to Weighted Average LIBOR |   |  |  |
| CLO I loan contractual interest income         | \$18,233                     | \$409,772                                 | 4.39                                       | % 0.28                 | % 4.11                           | % |  |  |
| CLO I ABS issued contractual interest expense  | (4,390)                      | (422,651)                                 | 1.02                                       | % 0.28                 | % 0.74                           | % |  |  |
| CLO II loan contractual interest income        | 8,341                        | 182,117                                   | 4.52                                       | % 0.35                 | % 4.17                           | % |  |  |
| CLO II ABS issued contractual interest expense | (4,841)                      | (320,000)                                 | 2.21                                       | % 0.35                 | % 1.86                           | % |  |  |
| Net CLO contractual interest                   | \$17,343                     | N/A                                       | N/A  | N/A                    | N/A                              |   |  |  |

(In thousands)

|   | Year Ended December 31, 2012 |   |  |                        |                                  |   |  |  |
|---|------------------------------|---|--|------------------------|----------------------------------|---|--|--|
|   | Interest Income (Expense)    | Average CLO Loan (CLO ABS Issued) Balance | Weighted Average Contractual Interest Rate | Weighted Average LIBOR | Spread to Weighted Average LIBOR |   |  |  |
| CLO I loan contractual interest income        | \$21,547                     | \$428,166                                 | 4.95                                       | % 0.45                 | % 4.50                           | % |  |  |
| CLO I ABS issued contractual interest expense | (5,202)                      | (431,003)                                 | 1.19                                       | % 0.45                 | % 0.74                           | % |  |  |
| Net CLO contractual interest                  | \$16,345                     | N/A                                       | N/A  | N/A                    | N/A                              |   |  |  |

Contractual interest of \$18.2 million was earned on the performing loans held by our CLO I for the year ended December 31, 2013. The annualized weighted average contractual interest rate on the performing loans was 4.39%

with a spread to weighted average LIBOR of 4.11% for the year ended December 31, 2013. Interest expense related to CLO I ABS issued was \$4.4 million for the year ended December 31, 2013. The annualized weighted average contractual interest rate on the CLO I ABS issued during the year was 1.02% with a spread to weighted average LIBOR of 0.74%. Contractual interest of \$8.3 million was earned on the performing loans held by our CLO II for the year ended December 31, 2013. The annualized weighted average contractual interest rate on the performing loans was 4.52% with a spread to weighted average LIBOR of 4.17% for the year ended December 31, 2013. Interest expense related to CLO II ABS issued was \$4.8 million for the year ended December 31, 2013. The annualized weighted average contractual interest rate on the CLO II ABS issued during the year was 2.21% with a spread to weighted average LIBOR of 1.86%.

Contractual interest of \$21.5 million was earned on the performing loans held by our CLO I for the year ended December 31, 2012. The annualized weighted average contractual interest rate on the performing loans was 4.95% with a spread to weighted average LIBOR of 4.50% for the year ended December 31, 2012. Interest expense related to ABS issued was \$5.2 million for the year ended December 31, 2012. The annualized weighted average contractual interest rate on the ABS issued during the year was 1.19% with a spread to weighted average LIBOR of 0.74%.

#### *Provision for Loan Losses*

Provision for loan losses increased \$0.4 million, or 19.5%, from \$2.2 million for the year ended December 31, 2012 to \$2.6 million for the same period in 2013. As a percent of net revenues after provision for loan losses, provision for loan losses decreased from 2.2% for the year ended December 31, 2012 to 1.8% for the year ended December 31, 2013.

Total segment provision for loan losses decreased from \$0.2 million for the year ended December 31, 2012 to \$0.1 million for the year ended December 31, 2013. Total segment provision for loan losses is a non-GAAP financial measure that aggregates our segment reported provision for loan losses across each segment. Our total segment provision for loan losses was solely recognized in our Investment Income segment in 2013, and in 2012. As a percent of total segment adjusted net revenues, segment provision for loan losses decreased from 0.2% for the year ended December 31, 2012 to 0.0% for the same period in 2013.

## Expenses

### Non-Interest 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 \$36.0 million, or 54.2%, from \$66.4 million for the year ended December 31, 2012 to \$102.4 million for the year ended December 31, 2013.

Employee payroll, taxes and benefits, and consultant fees, increased \$2.8 million, or 8.1%, from \$34.4 million for the year ended December 31, 2012 to \$37.2 million for the year ended December 31, 2013, primarily due to an increase in average headcount and the effect of a full year of base pay increases made during 2013.

Performance-based bonus and commissions increased \$30.4 million, or 103.1%, from \$29.5 million for the year ended December 31, 2012 to \$59.9 million for the same period in 2013. The increase was primarily due to an increase in total net revenues after provision for loan losses from \$100.9 million for the year ended December 31, 2012 to \$149.2 million for the same period in 2013.

Equity-based compensation increased \$2.9 million, or 116.0%, from \$2.5 million for the year ended December 31, 2012 to \$5.4 million for the year ended December 31, 2013. The change reflects an increase in performance-based RSU expense of \$0.2 million, stock option expenses of \$0.9 million, and expense related to the RSUs issued in connection with the 2011 annual bonus of \$1.7 million.

Compensation and benefits as a percentage of net revenues after provision for loan losses increased from 65.8% for the year ended December 31, 2012 to 68.5% for the same period in 2013.

Compensation and benefits in our adjusted net operating income, which includes 100% of deferred compensation expense and excludes RSU expense, increased from \$70.3 million for the year ended December 31, 2012 to \$104.4 million for the year ending December 31, 2013. This increase was attributed to the performance-based bonus and commissions. See “*Adjusted Operating Net Income (Non-GAAP Financial Measure)*,” above.

*Administration*

Administration expenses increased \$2.5 million, or 40.0%, from \$6.2 million for the year ended December 31, 2012 to \$8.7 million for the year ended December 31, 2013. The increase related to \$2.5 million underwriting expenses paid by HCAP Advisors in connection with an agreement with HCC. As a percentage of total net revenues after provision for loan losses, administration expense was 6.1% and 5.8% of total net revenues after provision for loan losses for the years ended December 31, 2012 and 2013, respectively.

*Brokerage, Clearing and Exchange Fees*

Brokerage, clearing and exchange fees decreased \$0.3 million, or 6.9%, from \$3.8 million for the year ended December 31, 2012 to \$3.5 million for the year ended December 31, 2013. The decrease was primarily due to a decrease in trading volume. As a percentage of total net revenues after provision for loan losses, our brokerage, clearing and exchange fees decreased from 3.8% for the year ended December 31, 2012 to 2.4% for the year ended 2013.

*Travel and Business Development*

Travel and business development expense increased \$1.0 million, or 30.4%, from \$3.4 million for the year ended December 31, 2012 to \$4.4 million for the year ended December 31, 2013. The increase primarily reflects a \$1.3 million increase in travel expense, driven by a 13.4% increase in travel volume. Reimbursements from clients, which offset travel expense, were \$1.0 million and \$1.2 million for the years ended December 31, 2012 and 2013, respectively. As a percentage of total net revenues after provision for loan losses, travel and business development expense was 3.4% and 3.0% for the years ended December 31, 2012 and 2013, respectively.

*Communications and Technology*

Communications and technology expense was \$3.5 million for the years ended December 31, 2012 and 2013. As a percentage of total net revenues after provision for loan losses, communications and technology expense decreased from 3.5% for the year ended December 31, 2012 to 2.4% for the year ended December 31, 2013.

*Professional Fees*



Professional fees increased \$0.4 million, or 8.9%, from \$3.6 million for the year ended December 31, 2012 to \$4.0 million for the year ended December 31, 2013. As a percentage of total net revenues after provision for loan losses, professional fees decreased from 3.6% for the year ended December 31, 2012 to 2.7% for the year ended December 31, 2013.

*Other Expenses*

Other expenses increased \$0.7 million, or 14.9%, from \$4.5 million for the year ended December 31, 2012 to \$5.1 million for the year ended December 31, 2013. As a percentage of total net revenues after provision for loan losses, other expenses increased from 4.4% for the year ended December 31, 2012 to 3.4% for the same period in 2013.

*Net Income (Loss) Attributable to Non-controlling Interest*

Net income attributable to non-controlling interest increased \$4.8 million from \$5.2 million for the year ended December 31, 2012 to \$10.0 million of income for the year ended December 31, 2013. Non-controlling interest for the year ended December 31, 2013 includes the interest of third parties in CLO I, CLO II (effective April 30, 2013), HGC, HGC II (effective October 1, 2012), HCC LLC (effective August 8, 2011 through May 2, 2013), and HCAP Advisors (effective May 1, 2013), all partially-owned subsidiaries consolidated in our financial statements. Non-controlling interest for the year ended December 31, 2012 includes the interest of third parties in CLO I, HGC, HGC II (effective October 1, 2012), and HCC LLC, all partially-owned subsidiaries consolidated in our financial statements. The increase in net income attributable to non-controlling interest reflected increases of \$8.0 million related to HGC and HGC II, partially offset by \$1.7 million loss at HCAP Advisors and \$1.4 million decrease in HCC LLC, which was deconsolidated on May 2, 2013.

*Provision for Income Taxes*

For the years ended December 31, 2013 and 2012, we recorded a tax expense of \$4.0 million and \$1.6 million, respectively. The effective tax rate for the years ended December 31, 2013 and 2012 was 22.5% and 16.6%, respectively. The increase in the effective tax rate was primarily attributable to deconsolidation of HCC LLC, which was consolidated for financial reporting purposes but not for tax purposes.

Our adjusted operating net income assumes a combined federal, state and local income tax rate of 42% and 38% for the years ended December 31, 2012 and 2013, respectively. Segment income tax expense decreased \$2.8 million from \$11.3 million for the year ended December 31, 2012 to \$8.5 million for the year ended December 31, 2013.

**Year Ended December 31, 2012, Compared to Year Ended December 31, 2011**

**Revenues**

*Investment Banking*

Investment banking revenues increased \$4.9 million, or 10.6%, from \$46.1 million for the year ended December 31, 2011 to \$51.0 million for the same period in 2012. As a percentage of total net revenues after provision for loan

losses, investment banking revenues increased from 41.3% for the year ended December 31, 2011 to 50.5% for the year ended December 31, 2012.

Our segment reported investment banking revenues, earned in our Broker-Dealer segment, increased \$5.1 million, or 11.0%, from \$46.1 million for the year ended December 31, 2011 to \$51.2 million for the same period in 2012. Private capital market and other revenues increased \$6.5 million, from \$3.7 million for the year ended December 31, 2011 to \$10.2 million for the year ended December 31, 2012. We executed five private placement transactions in 2011 compared to 12 in 2012. Public equity underwriting revenues increased \$2.4 million, or 9.1%, from \$26.5 million for the year ended December 31, 2011 to \$29.0 million for the year ended December 31, 2012. We executed 82 public equity underwriting transactions in 2012 compared to 56 in 2011. We acted as a lead manager on 17 transactions in 2012 and nine in 2011. Our debt and convertible revenues decreased \$3.2 million, or 50.5%, from \$6.3 million for the year ended December 31, 2011 to \$3.1 million for the year ended December 31, 2012. We executed 18 debt and convertible transactions in 2012 compared to seven in the same period in 2011. Our strategic advisory revenues decreased \$0.7 million, or 6.9%, from \$9.6 million for the year ended December 31, 2011 to \$8.9 million for the year ended December 31, 2012. We executed 12 strategic advisory transactions in 2012 compared to 18 in 2011. As a percentage of total adjusted net revenues, investment banking revenues increased from 37.7% for the year ended December 31, 2011 to 41.8% for the year ended December 31, 2012.

#### *Brokerage Revenues*

Brokerage revenues earned in our Broker-Dealer segment decreased \$3.6 million, or 14.0%, from \$25.5 million for the year ended December 31, 2011 to \$21.9 million for the year ended December 31, 2012. The decrease was primarily the result of reduced trading volume. Brokerage revenues decreased as a percentage of total net revenues after provision for loan losses, from 22.8% for the year ended December 31, 2011 to 21.7% for the year ended December 31, 2012. On an adjusted basis, brokerage revenues decreased from 20.8% for the year ended December 31, 2011 to 17.9% for the year ended December 31, 2012 as a percentage of adjusted net revenue after provision for loan losses.

*Asset Management Related Fees*

| <i>(In thousands)</i>                               | <b>Year Ended<br/>December 31,</b> |             |
|---|------------------------------------|-------------|
|   | <b>2012</b>                        | <b>2011</b> |
| <b>Base management fees:</b>                        |                                    |             |
| Fees reported as asset management fees              | \$9,433                            | \$9,708     |
| Fees reported as other income                       | 1,956                              | 2,848       |
| Fees earned at HGC, HGC II and HCC LLC              | 1,112                              | 759         |
| Total base management fees                          | 12,501                             | 13,315      |
| <b>Incentive fees:</b>                              |                                    |             |
| Fees reported as asset management fees              | \$6,342                            | \$10,077    |
| Fees reported as other income                       | -                                  | 381         |
| Fees earned at HGC, HGC II and HCC LLC              | 1,188                              | -           |
| Total incentive fees                                | 7,530                              | 10,458      |
| <b>Other fee income:</b>                            |                                    |             |
| Fundraising fees                                    | \$109                              | \$1,107     |
| New York Mortgage Trust termination fee             | 1,735                              | -           |
| Total other fee income                              | 1,844                              | 1,107       |
| <b>Asset management related fees:</b>               |                                    |             |
| Fees reported as asset management fees              | \$15,775                           | \$19,785    |
| Fees reported as other income                       | 3,800                              | 4,336       |
| Fees earned at HGC, HGC II and HCC LLC              | 2,300                              | 759         |
| Total Segment asset management related fee revenues | \$21,875                           | \$24,880    |
| Consolidation adjustment                            | (2,300 )                           | (759 )      |
| Adjusted total asset management related fees:       | \$19,575                           | \$24,121    |

Fees reported as asset management fees decreased \$4.0 million, or 20.3%, from \$19.8 million for the year ended December 31, 2011 to \$15.8 million for the year ended December 31, 2012. As a percentage of total net revenues after provision for loan losses, asset management revenues decreased from 17.7% for the year ended December 31, 2011 to 15.6% for the year ended December 31, 2012. Fees reported as other income decreased \$0.5 million, or 12.4% from \$4.3 million for the year ended December 31, 2011 to \$3.8 million for the year ended December 31, 2012. As a percentage of total net revenues after provision for loan losses, other income decreased from 3.9% for the year ended December 31, 2011 to 3.8% for the same period in 2012.

Total segment asset management related fees include base management fees and incentive fees for our funds and CLOs under management, as well as other income from fee sharing arrangements with, and fees earned to raise capital for, third-party investment partnerships or funds. Adjusted asset management related fees is a non-GAAP financial

measure that adjusts our total segment asset management related fees by reversing the elimination of those fees in the consolidation of HGC, HGC II and HCC LLC. Adjusted asset management related fees are reconciled to the GAAP measure, total segment asset management fee revenues, in the table above. We believe that presenting adjusted asset management related fees is useful to investors as a means of assessing the performance of JMP Group's combined asset management activities, including its fundraising and other services for third parties. We believe that adjusted asset management-related fee revenues provides useful information by indicating the relative contributions of base management fees and performance-related incentive fees, thus facilitating a comparison of those fees in a given period to those in prior and future periods. We also believe that asset management-related fee revenue is a more meaningful measure than standalone asset management fees as reported, because asset management-related fee revenues represent the combined impact of JMP Group's various asset management activities on the Company's total net revenues.

Total segment asset management related fee revenue decreased \$3.1 million from \$24.9 million for the year ended December 31, 2011 to \$21.9 million for the year ended December 31, 2012. The decrease was attributed to declines in base management fees and incentive fees, partially offset by an increase in other fee income. Base management fees were \$13.3 million and \$12.5 million for the years ended December 31, 2011 and 2012, respectively. Base management fees reported as asset management fees decreased \$0.3 million from \$9.7 million for the year ended December 31, 2011 to \$9.4 million for the year ended December 31, 2012, and was driven by the \$1.1 million reduction of NYMT management fees, partially offset by the addition of \$0.8 million fees related to HFF, a new fund added in January 2012. Base management fees reported as other income decreased from \$2.8 million to \$2.0 million, driven by a \$0.8 million settlement fee received in 2011 from the termination of JMPCA as a collateral manager. Total incentive fees decreased \$3.0 million from \$10.5 million for the year ended December 31, 2011 to \$7.5 million for the same period in 2012. The decrease in incentive fees was driven by a decrease of \$3.7 million related to HSCP and a \$0.7 million decline related to NYMT, partially offset by an increase of incentive fees earned at HGC of \$1.2 million. Other income increased \$0.7 million, resulting from the termination fee received in 2012 associated with the December 31, 2011 termination of our advisory agreement with NYMT. On an adjusted basis, adjusted asset management related fees decreased from 20.3% for the year ended December 31, 2011 to 17.9% for the year ended December 31, 2012 as a percentage of adjusted net revenues after provision for loan losses.

*Principal Transactions*

Principal transaction revenues increased \$8.9 million from \$1.6 million for the year ended December 31, 2011 to \$10.5 million for the same period in 2012. As a percentage of total net revenues after provision for loan losses, principal transaction revenues increased from 1.5% for the year ended December 31, 2011 to 10.4% for the year ended December 31, 2012.

Total segment principal transaction revenues increased \$5.2 million from \$1.1 million for the year ended December 31, 2011 to \$6.3 million for the same period in 2012. Total segment principal transaction revenues is a non-GAAP financial measure that aggregates our segment reported principal transaction revenues across each segment. We believe that presenting total segment principal transaction revenues is useful to investors as a means of assessing the performance of JMP Group's combined investment activities. The principal transaction revenues for 2012 and 2011 were based in our Investment Income segments. Total segment principal transaction revenues are reconciled to the GAAP measure, total principal transaction revenues, in the table below.

| <i>(In thousands)</i>  | <b>Year Ended</b>            |             |
|--|------------------------------|-------------|
|  | <b>December 31,<br/>2012</b> | <b>2011</b> |
| Equity and other securities excluding non-controlling interest | \$2,704                      | \$988       |
| Warrants and other investments                                 | 577                          | (757 )      |
| Investment partnerships  | 3,039                        | 849         |
| Total Segment principal transaction revenues                   | 6,320                        | 1,080       |
| Operating adjustment addbacks                                  | 1,102                        | 440         |
| Non-controlling interest in HGC, HCC and HMOP                  | 3,115                        | 95          |
| Total principal transaction revenues                           | \$10,537                     | \$1,615     |

The increase primarily reflects higher revenue from our equity investment and other securities and investment partnerships. Revenues from equity and other securities increased \$1.7 million from \$1.0 million for the year ended December 31, 2011 to \$2.7 million for the same period in 2012, driven primarily by a \$1.1 million increase in unrealized gains in our principal investment portfolio. Revenues from our investment partnerships increased \$2.2 million from \$0.8 million for the year ended December 31, 2011 to \$3.0 million for the year ended December 31, 2012. Revenues from warrants and other investments increased by \$1.4 million from a loss of \$0.8 million for the year ended December 31, 2011 to revenues of \$0.6 million for the year ended December 31, 2012. This increase was primarily driven by a \$0.8 million gain in redemptions from Class D Preferred Units of Sanctuary Wealth Services LLC ("Sanctuary") in 2012. On an adjusted basis, as a percentage of total net revenues after provision for loan losses, principal transaction revenues increased from 0.9% for the year ended December 31, 2011 to 5.2% for the year ended December 31, 2012.

*Gain on Sale, Payoff and Mark-to-market of Loans*

Gain on sale, payoff and mark-to-market of loans decreased \$9.7 million, or 57.3%, from \$17.0 million for the year ended December 31, 2011 to \$7.3 million for the same period in 2012, with \$6.6 million of the gain generated at JMP Credit and \$0.5 million generated at HCC LLC. At JMP Credit, during the year ended December 31, 2012, 127 loans were sold or paid off, resulting in a total net gain of \$6.4 million. Of the total net gain, \$6.1 million was related to 90 loan payoffs, where the borrowers repaid the loans at a premium to our carrying value. The remaining \$0.3 million related to 37 loans, three of which were sold at a discount to our carrying value and 34 of which were sold at par, which was a premium to our carrying value. While we expect further gains from loan payoffs in future periods, these revenues are highly unpredictable as we are not actively marketing the loans collateralized by asset-backed securities for sale. In addition, at JMP Credit \$0.2 million reflected the fair value adjustments of the loan held for sale. At HCC LLC, a \$0.6 million gain was generated, which was comprised of \$0.3 million related to the sale of loans and \$0.3 million to reflect the fair value adjustments of small business loans. As a percentage of total net revenues after provision for loan losses, gain on sale, payoff and mark-to-market of loans decreased from 15.2% for the year ended December 31, 2011 to 7.2% for the year ended December 31, 2012.

Gain on sale, payoff and mark-to-market of loans was earned in our Investment Income segment. On a segment reporting basis, the gain on sale, payoff and mark-to-market of loans in our Investment Income segment excludes the financial impact of gains or losses due to the sale or payoff of loans originally included in the CLO I portfolio acquired by JMP Group in April 2009. The segment reported gain on sale, payoff and mark-to-market of loans also excludes unrealized mark-to-market gains or losses on the investment portfolio at HCC LLC. Our segment reported gain on sale, payoff and mark-to-market of loans in the Investment Income segment decreased \$0.3 million, or from \$2.2 million for the year ended December 31, 2011 to \$1.9 million for the year ended December 31, 2012. Gain on sale, payoff and mark-to-market of loans decreased from 1.8% for the year ended December 31, 2011 to 1.6% for the year ended December 31, 2012 as a percentage of total segment adjusted net revenues.

*Net Dividend Income*

Net dividend income decreased from \$1.4 million for the year ended December 31, 2011 to a loss of \$29 thousand for the same period in 2012. The net dividend income in 2011 primarily comprised of dividend income from our investments in NYMT and in our principal investment portfolio. The decline resulted from the sale of our NYMT investments in 2012.

Our net dividend income of \$1.4 million for the year ended December 31, 2011 was comprised of \$0.8 million of net dividend income from our investment in NYMT and \$0.6 million of net dividend income from our principal investment portfolio, both earned in our Investment Income segment. Our net dividend loss for the year ended December 31, 2012 was primarily comprised of \$0.2 million of net dividend income from our investment in HCC LLC, earned in our Investment Income segment, which was eliminated in consolidation. As a percentage of total segment adjusted net revenues, net dividend income decreased from 1.1% for the year ended December 31, 2011 to 0.2% for the year ended December 31, 2012.





*Net Interest Expense*

| <i>(In thousands)</i>                         | <b>Year Ended</b>   |             |
|---|---------------------|-------------|
|   | <b>December 31,</b> |             |
|   | <b>2012</b>         | <b>2011</b> |
| CLO I loan contractual interest income        | \$21,547            | \$21,814    |
| CLO I ABS issued contractual interest expense | (5,202 )            | (4,582 )    |
| Net CLO I contractual interest                | 16,345              | 17,232      |
| Other interest income                         | 2,968               | 4,097       |
| Total Segment net interest income             | \$19,313            | \$21,329    |
| CLO I loan liquidity discount accretion       | 4,691               | 8,748       |
| CLO I ABS liquidity discount amortization     | (33,899)            | (30,234)    |
| Net CLO I liquidity discount amortization     | (29,208)            | (21,486)    |
| HCC LLC interest income                       | 3,774               | 230         |
| HCC LLC interest expense                      | (974 )              | (127 )      |
| Net HCC LLC interest income                   | 2,800               | 103         |
| Other interest income adjustment              | -                   | (2,337 )    |
| Total net interest expense                    | \$(7,095 )          | \$(2,391 )  |

Net interest expense increased \$4.7 million, or 196.7% from \$2.4 million for the year ended December 31, 2011 to \$7.1 million for the year ended December 31, 2012. Net interest expense included liquidity discount amortization of \$21.5 million and \$29.2 million for the years ended December 31, 2011 and December 31, 2012, respectively. As a percentage of total net revenues after provision for loan losses, net interest expense increased from 2.1% for the year ended December 31, 2011 to 7.0% for the year ended December 31, 2012.

Total segment net interest income decreased from \$21.3 million for the year ended December 31, 2011 to \$19.3 million for the year ended December 31, 2012. Our total segment net interest income excludes net amortization of liquidity discounts on loans and asset-backed securities issued. Net interest income is earned primarily in our Interest Income segment, and largely reflects net CLO I contractual interest. Total segment net interest income is a non-GAAP financial measure that aggregates our segment reported net interest income (expense) across each segment. We believe that presenting total segment net interest income is useful to investors as a means of assessing the performance of JMP Group's combined credit activities. Total segment net interest income is reconciled to the GAAP measure, total net interest expense, in the table above. As a percentage of total segment adjusted net revenues, net interest income decreased from 17.4% for the year ended December 31, 2011 to 15.8% for the year ended December 31, 2012.

The following table sets forth contractual interest income and expense related to CLO I loans and ABS issued and their weighted average contractual interest rates:

| <i>(In thousands)</i>                         | <b>Year Ended December 31, 2012</b> |  |   |                               |   |   |  |  |
|---|-------------------------------------|--|---|-------------------------------|---|---|--|--|
|   | <b>Interest Income (Expense)</b>    | <b>Average CLO Loan (CLO ABS Issued) Balance</b> | <b>Weighted Average Contractual Interest Rate</b> | <b>Weighted Average LIBOR</b> | <b>Spread to Weighted Average LIBOR</b> |   |  |  |
| CLO I loan contractual interest income        | \$21,547                            | \$428,166  | 4.95  | % 0.45                        | % 4.50                                  | % |  |  |
| CLO I ABS issued contractual interest expense | (5,202 )                            | (431,003)  | 1.19  | % 0.45                        | % 0.74                                  | % |  |  |
| Net CLO contractual interest                  | \$16,345                            | N/A  | N/A   | N/A                           | N/A                                     |   |  |  |

| <i>(In thousands)</i>                         | <b>Year Ended December 31, 2011</b> |  |   |                               |   |   |  |  |
|---|-------------------------------------|--|---|-------------------------------|---|---|--|--|
|   | <b>Interest Income (Expense)</b>    | <b>Average CLO Loan (CLO ABS Issued) Balance</b> | <b>Weighted Average Contractual Interest Rate</b> | <b>Weighted Average LIBOR</b> | <b>Spread to Weighted Average LIBOR</b> |   |  |  |
| CLO I loan contractual interest income        | \$21,814                            | \$444,758  | 4.84  | % 0.31                        | % 4.53                                  | % |  |  |
| CLO I ABS issued contractual interest expense | (4,582 )                            | (431,003)  | 1.05  | % 0.31                        | % 0.74                                  | % |  |  |
| Net CLO contractual interest                  | \$17,232                            | N/A  | N/A   | N/A                           | N/A                                     |   |  |  |

Contractual interest of \$21.5 million was earned on the performing loans held by our CLO I for the year ended December 31, 2012. The annualized weighted average contractual interest rate on the performing loans was 4.95% with a spread to weighted average LIBOR of 4.50% for the year ended December 31, 2012. Interest expense related to ABS issued was \$5.2 million for the year ended December 31, 2012. The annualized weighted average contractual interest rate on the ABS issued during the year was 1.19% with a spread to weighted average LIBOR of 0.74%.

Contractual interest of \$21.8 million was earned on the performing loans held by our CLO I for the year ended December 31, 2011. The annualized weighted average contractual interest rate on the performing loans was 4.84% with a spread to weighted average LIBOR of 4.53% for the year ended December 31, 2011. Interest expense related to ABS issued was \$4.6 million for the year ended December 31, 2011. The annualized weighted average contractual interest rate on the ABS issued during the year was 1.05% with a spread to weighted average LIBOR of 0.74%.

#### *Provision for Loan Losses*

Provision for loan losses increased \$0.5 million, or 27.7%, from \$1.7 million for the year ended December 31, 2011 to \$2.2 million for the same period in 2012. As a percent of net revenues after provision for loan losses, provision for loan losses increased from 1.6% for the year ended December 31, 2011 to 2.2% for the year ended December 31, 2012.

Total segment provision for loan losses increased from \$34 thousand for the year ended December 31, 2011 to \$0.2 million for the year ended December 31, 2012. Total segment provision for loan losses is a non-GAAP financial measure that aggregates our segment reported provision for loan losses across each segment. See tables on pages [41-42] for a reconciliation to segment reported provision for loan losses. Our total segment provision for loan losses in 2012 was solely recognized in our Corporate Credit segment in 2012, and in 2011 was comprised of provisions for loan losses of negative \$0.5 million and \$0.5 million in our Corporate Credit and Corporate segments, respectively. The increase was primarily attributed to a \$0.5 million recovery recorded in Corporate segment in 2011 related to loans held for investment, partially offset by \$0.4 million less provisions for loan losses recorded to our general reserves for loans collateralizing ABS from \$0.5 million in 2011 to \$0.1 million in 2012. As a percent of total segment adjusted net revenues, segment provision for loan losses increased from 0.0% for the year ended December 31, 2011 to 0.2% for the same period in 2012.

### **Expenses**

#### *Non-Interest 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, decreased \$22.6 million, or 25.4%, from \$89.0 million for the year ended December 31, 2011 to \$66.4 million for the year ended

December 31, 2012.

Employee payroll, taxes and benefits, and consultant fees, increased \$0.5 million, or 1.6%, from \$33.9 million for the year ended December 31, 2011 to \$34.4 million for the year ended December 31, 2012, primarily due to the effect of a full year of base pay increases made during 2012.

Performance-based bonus and commissions decreased \$15.3 million, or 34.2%, from \$44.8 million for the year ended December 31, 2011 to \$29.5 million for the same period in 2012. The decrease was primarily due to a decrease in total net revenues after provision for loan losses from \$111.4 million for the year ended December 31, 2011 to \$101.1 million for the same period in 2012.

Equity-based compensation decreased \$7.8 million, or 75.8%, from \$10.3 million for the year ended December 31, 2011 to \$2.5 million for the year ended December 31, 2012. The change reflects a decrease of \$7.0 million of performance-based RSUs, and a decrease of \$0.8 million related to RSUs granted in connection with the initial public offering. The decrease related to performance-based RSUs is driven by a change in vesting criteria of performance-based RSUs granted in 2012 causing deferred compensation to be recognized over two years, as opposed to prior years' performance-based RSUs which were recognized immediately.

Compensation and benefits as a percentage of net revenues after provision for loan losses decreased from 79.8% for the year ended December 31, 2011 to 65.8% for the same period in 2012.

Compensation and benefits in our adjusted net operating income, which includes 100% of deferred compensation expense and excludes RSU expense, decreased from \$73.5 million for the year ended December 31, 2011 to \$70.3 million for the year ending December 31, 2012. This decline was attributed to the decline in performance-based bonus and commissions. See "*Adjusted Operating Net Income (Non-GAAP Financial Measure)*," above.

#### *Administration*

Administration expenses decreased \$0.5 million, or 7.0%, from \$6.6 million for the year ended December 31, 2011 to \$6.2 million for the year ended December 31, 2012, partially due to a \$0.2 million decrease in conference fees, a \$0.2 million decrease in placement and recruiting fees and a \$0.2 million decrease in building repairs and maintenance. As a percentage of total net revenues after provision for loan losses, administration expense was 6.0% and 6.1% of total net revenues after provision for loan losses for the years ended December 31, 2011 and 2012, respectively.

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

Brokerage, clearing and exchange fees decreased \$0.9 million, or 19.6%, from \$4.7 million for the year ended December 31, 2011 to \$3.8 million for the year ended December 31, 2012. The decrease was primarily due to a decrease in trading volume. As a percentage of total net revenues after provision for loan losses, our brokerage, clearing and exchange fees decreased from 4.2% for the year ended December 31, 2011 to 3.8% for the year ended 2012.

*Travel and Business Development*

Travel and business development expense decreased \$0.3 million, or 8.0%, from \$3.7 million for the year ended December 31, 2011 to \$3.4 million for the year ended December 31, 2012. The decrease primarily reflects a \$0.3 million decrease in travel expense, driven by a 12.1% decrease in travel volume. Reimbursements from clients were \$1.1 million and \$1.0 million for the years ended December 31, 2011 and 2012, respectively. As a percentage of total net revenues after provision for loan losses, travel and business development expense was 3.3% and 3.4% for the years ended December 31, 2011 and 2012, respectively.

*Communications and Technology*

Communications and technology expense decreased \$0.5 million, or 12.2%, from \$4.0 million for the year ended December 31, 2011 to \$3.5 million for the year ended December 31, 2012. As a percentage of total net revenues after provision for loan losses, communications and technology expense decreased from 3.6% for the year ended December 31, 2011 to 3.4% for the year ended December 31, 2012.

*Professional Fees*

Professional fees increased \$0.6 million, or 22.8%, from \$3.0 million for the year ended December 31, 2011 to \$3.6 million for the year ended December 31, 2012. As a percentage of total net revenues after provision for loan losses, professional fees increased from 2.7% for the year ended December 31, 2011 to 3.6% for the year ended December 31, 2012.

*Impairment Loss on Purchased Management Contract*

On June 11, 2010, we agreed to purchase the collateral management contracts for two CLOs from Princeton Advisory Group, Inc. for up to \$5.0 million. The transfers of the contracts were subject to the receipt of certain consents and other conditions. On September 8, 2010, we completed the purchase of one of the two management contracts for \$3.8 million, and the contract was transferred to JMPCA. However, since a single investor had previously acquired control of the right to transfer the management contract without cause at any time with 90 days' notice, we recorded an impairment charge of \$2.8 million for the quarter ended September 30, 2010. We later restructured the transaction to provide us with indemnity from the seller in the amount of \$2.6 million, which was collateralized by certain assets and \$1.0 million in cash. We determined the initial carrying value of the purchased management contract to be \$1.0 million. An impairment loss, calculated as the difference between the estimated fair value and the carrying value of

the asset, is recognized if the sum of the estimated undiscounted cash flows relating to the asset is less than the corresponding carrying value. We determined that the carrying value of the purchased management contract was impaired and recorded a \$0.7 million impairment charge for the quarter ended March 31, 2011. At that time, we also revised the estimated useful life of the asset. At June 30, 2011, the purchased management contract was fully amortized. For the years ended December 31, 2011 and 2010, the amortization expense was \$0.2 million and \$0.1 million, respectively. On December 6, 2011, the CLO's transaction documents and indenture were amended, which allowed the noteholders of this CLO to direct a liquidation of the collateral and redemption of the notes at any time with no requirement for full repayment of the notes, if such affected class voted in favor of receiving less than par. The CLO initiated liquidation proceedings in December 2011. During the fourth quarter of 2010, we were released from the obligation to purchase the second CLO management contract from Princeton Advisory Group, Inc.

#### *Other Expenses*

Other expenses increased \$0.4 million, or 9.5%, from \$4.1 million for the year ended December 31, 2011 to \$4.5 million for the year ended December 31, 2012. As a percentage of total net revenues after provision for loan losses, other expenses increased from 3.7% for the year ended December 31, 2011 to 4.4% for the same period in 2012.

#### *Net Income (Loss) Attributable to Non-controlling Interest*

Net income attributable to non-controlling interest increased \$5.4 million from a \$0.2 million loss for the year ended December 31, 2011 to \$5.2 million of income for the year ended December 31, 2012. Non-controlling interest for the year ended December 31, 2012 includes the interest of third parties in CLO I, HGC, HGC II (effective October 1, 2012) and HCC LLC, all partially-owned subsidiaries consolidated in our financial statements. Non-controlling interest for the year ended December 31, 2011 includes the interest of third parties in CLO I, HGC, and HCC LLC (effective August 8, 2011), all partially-owned subsidiaries consolidated in our financial statements. The increase in net income attributable to non-controlling interest reflected increases of \$1.3 million related to HGC and HGC II, \$1.2 million related to JMP Credit and CLO I, and \$2.5 million related to HCC LLC.

#### *Provision for Income Taxes*

For the years ended December 31, 2012 and 2011, we recorded a tax expense of \$1.6 million and a tax benefit of \$1.6 million, respectively. The effective tax rate for the years ended December 31, 2012 and 2011 was 16.6% and 38.4%, respectively. The 21.9% decrease in the effective tax rate was primarily attributable to the income associated with HGC, HGC II and HCC LLC, which are consolidated for financial reporting purposes but not for tax purposes.





Our adjusted operating net income assumes a combined federal, state and local income tax rate of 42%. Segment income tax expense increased \$2.2 million from \$9.1 million for the year ended December 31, 2011 to \$11.3 million for the year ended December 31, 2012.

## **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 year ended December 31, 2013 to demonstrate where our capital is invested and the financial condition of the Company.

### *Overview*

As of December 31, 2013, we had net liquid assets of \$49.4 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, deferred compensation paid in January 2014, note payable and non-controlling interest. We have satisfied our capital and liquidity requirements primarily through the net proceeds from the initial public offering, the January 2013 issuance of the 2013 Senior Notes, and internally generated cash from operations. 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 December 31, 2013 and December 31, 2012, we had Level 3 assets (financial instruments measured on a recurring basis whose fair value was determined using unobservable inputs that are not corroborated by market data) of \$112.1 million and \$87.4 million, respectively, which represented 10.0% and 12.3% of total assets, respectively. Level 3 assets increased by \$24.7 million, due to the purchased new assets of \$55.5 million, and the unrealized gain of \$21.2 million, partially offset by deconsolidation of \$40.3 million HCC Level 3 assets, the exchange of \$7.2 million of a private equity security in return for Level 2 assets related to an acquisition of the private company in which we held an investment by a publicly-listed company, and by the transfers of certain private equity securities into Level 2 of \$3.7 million. The transfers from Level 3 were a result of an initial public offering of one position in HGC, and an acquisition of one investment by a public company.

### *Liquidity Considerations Related to CLOs*

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. In December 2009, we repurchased the contingent consideration for \$1.8 million. As we own substantially all of the subordinated securities of the CLO, 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.

Our maximum exposure to loss of capital on the CLOs is the original April 7, 2009 investment of \$4.0 million plus the \$1.8 million paid to repurchase the contingent consideration related to the Cratos acquisition, \$17.3 million related to CLO II, and \$10.0 million investment related to CLO III plus any earnings retained in the CLOs since the acquisition date. However, for U.S. federal tax purposes, the CLOs are 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 over-collateralization 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 prior to the residual cash flow distributions to us.

The CLOs must comply with certain asset coverage tests, such as tests that restrict the amount of discounted obligations and obligations rated “CCC” or lower it can hold. During any time the CLO exceeds such a limit, our ability, as the manager of CLO I, 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 CLOs investment criteria are not given full par credit for purposes of calculation of the CLO over-collateralization (“OC”) tests. We were in compliance with all OC tests on the determination dates since February 2010. However, we have been in violation and may be in the future. If CLOs were to violate the Class E test, or any more senior tests, we would be required to pay 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 of all principal and interest outstanding on the notes.

For financial reporting purposes, the loans and asset-backed securities of the CLOs are consolidated on our balance sheet. The loans are reported at their cost adjusted for amortization of liquidity discount and credit reserves, both of which were recorded at the Cratos acquisition date, purchase discounts and allowance for loan losses. The asset-backed securities are recorded net of liquidity discount only. At December 31, 2013, we had \$727.3 million of loans collateralizing asset-backed securities, net, \$43.5 million of restricted cash and \$1.9 million of interest receivable funded by \$716.4 million of asset-backed securities issued, net, and interest payable of \$1.9 million. These assets and liabilities represented 68.9% of total assets and 64.0% of total liabilities respectively, reported on our Consolidated Statement of Financial Condition at December 31, 2013.

The tables below summarize the loans held by the CLOs grouped by range of outstanding balance, industry and Moody's Investors Services, Inc. rating category as of December 31, 2013.

*(Dollars in thousands)*

| Range of Outstanding Balance | As of December 31, 2013 |                 |                 |
|------------------------------|-------------------------|-----------------|-----------------|
|                              | Number of Loans         | Maturity Date   | Total Principal |
| \$0 - \$500                  | 26                      | 12/2013-8/2020  | \$9,678         |
| \$500 - \$2,000              | 217                     | 5/2014 -10/2021 | 302,283         |
| \$2,000 - \$5,000            | 120                     | 12/2014-12/2020 | 347,494         |
| \$5,000 - \$10,000           | 9                       | 5/2016 -6/2020  | 56,065          |
| Total                        | 374                     |                 | \$735,892       |

*(Dollars in thousands)*

| Industry  | As of December 31, 2013 |                     |                          |   |
|---|-------------------------|---------------------|--------------------------|---|
|   | Number of Loans         | Outstanding Balance | % of Outstanding Balance |   |
| Healthcare, Education & Childcare                                     | 37                      | \$ 86,522           | 11.9                     | % |
| Chemicals, Plastics and Rubber  | 19                      | 52,941              | 7.2                      | % |
| Hotels, Motels, Inns and Gaming                                       | 19                      | 42,658              | 5.8                      | % |
| Beverage, Food & Tobacco  | 19                      | 38,583              | 5.2                      | % |
| Retail Store  | 21                      | 37,686              | 5.1                      | % |
| High Tech Industries  | 16                      | 33,386              | 4.5                      | % |
| Automobile  | 13                      | 30,803              | 4.2                      | % |
| Diversified/Conglomerate Service                                      | 16                      | 28,105              | 3.8                      | % |
| Telecommunications  | 14                      | 26,211              | 3.6                      | % |
| Aerospace & Defense   | 15                      | 23,468              | 3.2                      | % |
| Banking, Finance, Insurance & Real Estate                             | 12                      | 23,096              | 3.2                      | % |
| Leisure , Amusement, Motion Pictures & Entertainment                  | 10                      | 21,492              | 2.9                      | % |
| Electronics   | 11                      | 19,704              | 2.8                      | % |
| Services: Consumer  | 7                       | 19,752              | 2.8                      | % |
| Oil & Gas   | 5                       | 19,839              | 2.7                      | % |
| Services: Business  | 10                      | 18,458              | 2.5                      | % |
| Personal & Non-Durable Consumer Products                              | 11                      | 15,205              | 2.1                      | % |
| Home and Office Furnishings, Housewares and Durable Consumer Products | 9                       | 15,768              | 2.1                      | % |
| Construction & Building   | 7                       | 15,451              | 2.1                      | % |
| Containers, Packaging and Glass                                       | 9                       | 15,005              | 2.0                      | % |
| Media: Broadcasting & Subscription                                    | 6                       | 14,091              | 1.9                      | % |
| Media: Diversified & Production                                       | 6                       | 13,320              | 1.8                      | % |
| Personal, Food & Misc Services  | 8                       | 12,128              | 1.6                      | % |
| Mining, Steel, Iron and Non-Precious Metals                           | 6                       | 11,530              | 1.6                      | % |
| Printing & Publishing   | 4                       | 9,885               | 1.3                      | % |

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|   |     |         |     |   |
|---|-----|---------|-----|---|
| Banking   | 6   | 9,191   | 1.2 | % |
| Finance   | 5   | 7,507   | 1.0 | % |
| Broadcasting & Entertainmt.                                   | 4   | 7,564   | 1.0 | % |
| Diversified/Conglomerate Mfg                                  | 8   | 6,153   | 0.8 | % |
| Environmental Industries                                      | 5   | 5,935   | 0.8 | % |
| Cargo Transport   | 4   | 5,924   | 0.8 | % |
| Ecological  | 5   | 5,410   | 0.7 | % |
| Utilities   | 4   | 5,342   | 0.7 | % |
| Transportation: Consumer                                      | 2   | 5,136   | 0.7 | % |
| Insurance   | 2   | 4,693   | 0.6 | % |
| Forest Products & Paper                                       | 3   | 3,926   | 0.5 | % |
| Textiles & Leather  | 2   | 3,705   | 0.5 | % |
| Energy: Electricity   | 2   | 2,990   | 0.4 | % |
| Personal Transportation                                       | 2   | 2,994   | 0.4 | % |
| Machinery (Non-Agriculture,Non-Construction & Non-Electronic) | 2   | 2,489   | 0.3 | % |
| Grocery   | 2   | 2,469   | 0.3 | % |
| Energy: Oil & Gas   | 1   | 2,066   | 0.3 | % |
| Capital Equipment   | 1   | 1,995   | 0.3 | % |
| Wholesale   | 1   | 2,000   | 0.3 | % |
| Farming & Agriculture   | 1   | 1,481   | 0.2 | % |
| Diversified Natural Resources, Precious Metals and Minerals   | 1   | 1,345   | 0.2 | % |
| Personal and Non-Durable Consumer Products (mfg only)         | 1   | 490     | 0.1 | % |
|   | 374 | 735,892 | 100 | % |

(Dollars in thousands)

| Moody's Rating Category | As of December 31, 2013 |                     | % of                |             |
|-------------------------|-------------------------|---------------------|---------------------|-------------|
|                         | Number of Loans         | Outstanding Balance | Outstanding Balance | Outstanding |
| Baa2                    | 1                       | \$ 2,000            | 0.3                 | %           |
| Baa3                    | 2                       | 14,058              | 1.9                 | %           |
| Ba1                     | 6                       | 16,988              | 2.3                 | %           |
| Ba2                     | 25                      | 65,518              | 8.9                 | %           |
| Ba3                     | 56                      | 134,521             | 18.3                | %           |
| B1                      | 95                      | 177,424             | 24.1                | %           |
| B2                      | 162                     | 276,765             | 37.5                | %           |
| B3                      | 20                      | 34,382              | 4.7                 | %           |
| Caa1                    | 5                       | 12,342              | 1.7                 | %           |
| Caa2                    | 1                       | 1,500               | 0.2                 | %           |
| Ca                      | 1                       | 394                 | 0.1                 | %           |
| Total                   | 374                     | \$ 735,892          | 100                 | %           |

#### *Other Liquidity Considerations*

The Company's indebtedness includes a term loan and revolving lines of credit related to JMP Group LLC's, our wholly-owned subsidiary ("JMPG LLC"), Credit Agreement with City National Bank ("CNB"), as defined below, entered into on August 3, 2006 (as so amended and restated, the "Credit Agreement") and borrowing on a line of credit related to HGC II, also defined below.

As of December 31, 2013 (after taking into account any payments under the Credit Agreement that day), JMPG LLC's total consolidated indebtedness under the Credit Agreement was \$17.9 million, comprised of a \$15.0 million term loan of JMPG LLC (the "Term Loan"), and \$2.9 million of outstanding indebtedness under HGC II's revolving line of credit. The Term Loan is being repaid in quarterly payments of \$1.2 million beginning March 31, 2014 and continuing through September 30, 2016, with a final payment of approximately \$1.3 million on December 31, 2016. The CNB Loans bear interest at LIBOR plus 2.25% or, at JMPG LLC's option, at CNB's prime rate.

The Revolving Line of Credit has a maximum principal balance of the lesser of (i) \$30.0 million, and (ii) \$58.5 million minus (a) the principal amount of the Term Loan, and (b) the principal amount of the Broker/Dealer Line of Credit (as defined below) then outstanding. Under the Credit Agreement, CNB has agreed to issue certain letters of credit in an amount not exceeding \$2.5 million, the stated amounts of which will be a reduction to the availability of the Revolving Line of Credit and drawings thereunder may be converted into drawings under the Revolving Line of Credit. The Revolving Line of Credit will remain available through April 30, 2014. On such date, any outstanding amount converts into a term loan (the "Converted Term Loan"). The Converted Term Loan will be repaid in quarterly

installments of 3.75% of such term loan for the first two years, 5.00% of such term loan for the next two years, and the remainder due at maturity on August 24, 2017.

The Credit Agreement provides that the proceeds of the CNB Loans are subject to the following restrictions: (i) the Initial Term Loan and up to \$5.0 million of the Revolving Line of Credit Loans may not be used for any purpose other than to fund certain permitted investments and acquisitions and to fund JMPG LLC's working capital needs in the ordinary course of its business; (ii) all other proceeds of the Revolving Line of Credit may not be used for any purpose other than to make investments in HCS and by HCS to make investments in loans that are made to persons that are not affiliates of borrower; and (iii) the Term Loan may not be used for any purpose other than to make equity investments in CLOs and by CLOs to make certain permitted investments in collateralized loan obligations.

The Credit Agreement includes minimum fixed charge and interest charge coverage ratios applicable to us and our subsidiaries, a minimum net worth covenant applicable to us and our subsidiaries and a minimum liquidity covenant applicable to JMPG LLC and its subsidiaries. As of December 31, 2013, we were in compliance with all of these financial covenants. The Credit Agreement also includes an event of default for a "change of control" that tests, in part, the composition of our ownership and an event of default if two or more of the members of the Executive Committee fail to be involved actively on an ongoing basis in the management of JMPG LLC or any of its subsidiaries.

The CNB Loans are guaranteed by HCS and secured by a lien on substantially all assets of JMPG LLC and HCS.

Separately, under a Revolving Note and Cash Subordination Agreement, dated as of April 8, 2011, by and between CNB and JMP Securities, as amended, JMP Securities has a subordinated revolving line of credit with CNB (the "Broker/Deal Line of Credit"). Draws on the Broker/Deal Line of Credit bear interest at the rate of prime. The Broker/Deal Line of Credit matures on May 6, 2015. There were no borrowings on this line of credit as of December 31, 2013. JMPG LLC has guaranteed the obligations under the Broker/Deal Line of Credit pursuant to a General Continuing Guaranty dated as of April 8, 2011.

On November 22, 2013, HGC II entered into a line of credit of \$3.0 million with CNB. The unused portion of the line bears interest at the rate of prime plus 0.5% per annum, paid quarterly. The line of credit will be available through December 1, 2015 or fifteen days prior to the expiration of the Commitment Period of HGC II unless renewed. The proceeds for this line of credit will be used to purchase investments, prior to capital calls from HGC II investors. The Company's outstanding balance on this line of credit was \$2.9 million as of December 31, 2013.

In January 2013, the Company raised approximately \$46.0 million from the sale of 8.00% Senior Notes. The notes will mature on January 15, 2023, and may be redeemed in whole or in part at any time or from time to time at the company's option on or after January 15, 2016, at a redemption price equal to the principal amount redeemed plus accrued and unpaid interest. The notes bear interest at a rate of 8.00% per year, payable quarterly on January 15, April 15, July 15 and October 15 of each year.

In January 2014, the Company raised an additional approximate \$48.3 million from the sale of 7.25% Senior Notes. The notes will mature on January 15, 2021, and may be redeemed in whole or in part at any time or from time to time at the company's option on or after January 15, 2017, at a redemption price equal to the principal amount redeemed plus accrued and unpaid interest. The notes bear interest at a rate of 7.25% per year, payable quarterly on January 15, April 15, July 15 and October 15 of each year, beginning April 15, 2014.

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 the first two months of 2013, we paid out \$19.2 million of cash bonuses for 2012, excluding employer payroll tax expense.

The Company currently intends to declare quarterly cash dividends on all outstanding shares of common stock. The Company's board of directors declared a quarterly cash dividend of \$0.035 per share of common stock in March, May and July 2013, and \$0.040 per share of common stock in October 2013. Those dividends were paid in April, May, August and November 2013 for the fourth quarter of 2012, the first, second and third quarter of 2013, respectively.

During the years ended December 31, 2013 and 2012, the Company repurchased 890,376 and 858,137 shares, respectively, of the Company's common stock at an average price of \$6.50 per share and \$6.58 per share, respectively, for an aggregate purchase price of \$5.8 million and \$5.7 million, respectively. Of the total shares repurchased during the years ended December 31, 2013 and 2012, 40,835 shares and 603,328 shares, respectively, were deemed to have been repurchased in connection with employee stock plans, whereby the Company's shares were issued on a net basis to employees for the payment of applicable statutory withholding taxes and therefore such withheld shares are deemed to be purchased by the Company. 356,728 of the shares repurchased in 2013 were repurchased from certain JMPCA employees at a discount to market price in conjunction with their use of said proceeds as a long term capital commitment to CLO II. 135,680 of the shares repurchased during the year ended December 31, 2013 were repurchased from an employee. The remaining shares were purchased on the open market.

We had total restricted cash of \$68.0 million comprised primarily of \$53.0 million of restricted cash at JMP Credit on December 31, 2013. This balance was comprised of \$6.9 million in interest received from loans in the CLO and \$46.1 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.

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 at least the next twelve months. If circumstances required it, we could improve our liquidity position by discontinuing repurchases of the Company's common stock, halting cash dividends on our common stock and reducing cash bonus compensation paid.

JMP Securities, our wholly-owned subsidiary and a registered securities broker-dealer, 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. 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 \$59.1 million and \$36.7 million, which were \$58.1 million and \$35.7 million in excess of the required net capital of \$1.0 million at December 31, 2013 and 2012, respectively. JMP Securities' ratio of aggregate indebtedness to net capital was 0.16 to 1 and 0.17 to 1 at December 31, 2013 and 2012, respectively.

A condensed table of cash flows for the years ended December 31, 2013, 2012 and 2011 is presented below.

| <i>(Dollars in thousands)</i>                         | <b>Year Ended December 31,</b> |             |             | <b>Change from 2012</b> |          | <b>Change from</b>  |          |
|---|--------------------------------|-------------|-------------|-------------------------|----------|---------------------|----------|
|   | <b>2013</b>                    | <b>2012</b> | <b>2011</b> | <b>to 2013</b>          | <b>%</b> | <b>2011 to 2012</b> | <b>%</b> |
|   |                                |             |             | <b>\$</b>               | <b>%</b> | <b>\$</b>           | <b>%</b> |
| Cash flows provided by operating activities           | \$32,039                       | \$7,243     | \$16,150    | \$24,796                | 342.3 %  | \$(8,907 )          | -55.2 %  |
| Cash flows used in investing activities               | (393,000)                      | (49,655)    | (16,473)    | (343,345)               | -691.5 % | (33,182)            | -201.4 % |
| Cash flows provided by (used in) financing activities | 359,792                        | 39,124      | (428 )      | 320,668                 | 819.6 %  | 39,552              | 9241.0 % |
| Total cash flows                                      | \$(1,169 )                     | \$(3,288 )  | \$(751 )    | \$2,119                 | 282.2 %  | \$(2,537 )          | -337.8 % |

### **Cash Flows for the Year Ended December 31, 2013**

Cash decreased by \$1.2 million during the year ended December 31, 2013, driven by cash used in investing activities.

Our operating activities provided \$32.0 million of cash from the net income of \$13.6 million and cash provided in the change in operating assets and liabilities of \$30.9 million, adjusted for the cash used in the non-cash revenue and expense items of \$12.5 million. The net change in operating assets and liabilities was driven by an increase in accrued compensation of \$38.4 million, partially offset by an increase of marketable securities of \$14.9 million and an



increase of receivables of \$7.1 million. The non-cash revenue and expense items included a \$16.5 million adjustment of fair value in other investments and \$7.8 million incentive fees reinvested in general partnership interests, partially offset by net amortization expense of liquidity discount of \$14.9 million.

Our investing activities used \$393.0 million of cash primarily due to the funding of loans collateralizing ABS issued of \$590.9 million and the purchases of other investments of \$76.5 million, partially offset by cash provided by sales and payoff of loans collateralizing ABS issued of \$220.1 million and \$49.3 million of repayments on loans collateralizing ABS. The increase in funding of loans collateralizing ABS primarily relates to the issuance of CLO II.

Our financing activities provided \$359.8 million of cash primarily due to proceeds from the issuance of ABS of \$311.6 million, proceeds from capital contributions from non-controlling interest holders of \$64.6 million and proceeds from bond issuance of \$46.0 million, partially offset by \$28.2 million repayment of the line of credit, \$26.7 million repayment of asset backed securities, and \$10.5 million repayment of note payable. Proceeds from the issuance of ABS are not available for general use by the Company and are restricted to lending activities by the CLOs.

### **Cash Flows for the Year Ended December 31, 2012**

Cash decreased by \$3.3 million during the year ended December 31, 2012, driven by cash used in investing activities.

Our operating activities provided \$6.9 million of cash from the net income of \$8.0 million, and non-cash revenue and expense items of \$12.1 million, adjusted for the cash used in the change in operating assets and liabilities of \$13.2 million. The non-cash revenue and expense items included net amortization expense of liquidity discount of \$29.2 million, partially offset by a gain on sale, payoff and mark-to-market of loans of \$7.3 million, and a \$5.3 million adjustment of fair value in other investments. The net change in operating assets and liabilities was driven by a decrease in accrued compensation of \$21.5 million.

Our investing activities used \$49.3 million of cash primarily due to the funding of loans collateralizing ABS issued of \$202.6 million, funding of small business loans of \$36.7 million, the purchases of other investments of \$28.1 million, and an increase of restricted cash reserved for lending of \$20.9 million, partially offset by cash provided by sales and payoff of loans collateralizing ABS issued of \$184.4 million, and \$39.4 million of repayments on loans collateralizing ABS.

Our financing activities provided \$39.1 million of cash primarily due to proceeds from capital contributions from non-controlling interest holders of \$34.0 million, and proceeds from issuance of note payable of \$40.1 million, partially offset by \$11.9 million repayment of the line of credit, \$8.7 million repayment of note payable, cash dividends paid to stockholders of \$5.8 million and the repurchase of our common stock for treasury of \$5.6 million.

**Cash Flows for the Year Ended December 31, 2011**

Cash decreased by \$0.8 million during the year ended December 31, 2011, primarily as a result of cash used in investing activities.

Our operating activities provided \$16.2 million of cash from the net loss of \$2.6 million, adjusted for the cash used in the change in operating assets and liabilities of \$14.5 million and non-cash revenue and expense items of \$4.2 million. The non-cash revenue and expense items included net amortization expense of liquidity discount of \$21.5 million and stock-based compensation expense of \$10.3 million partially offset by a loss on sale and payoff of loans of \$17.0 million.

Our investing activities used \$16.5 million of cash primarily due to the funding of loans collateralizing ABS issued of \$245.9 million, the purchases of other investments of \$17.0 million, and an increase of restricted cash reserved for lending of \$12.2 million, partially offset by cash provided by sales and payoff of loans collateralizing ABS issued of \$229.6 million, and \$28.5 million of repayments on loans collateralizing ABS.

Our financing activities used \$0.4 million of cash primarily due to proceeds from capital contributions from non-controlling interest holders of \$18.4 million, partially offset by issuance of note payable of \$7.0 million, the repurchase of our common stock for treasury of \$6.4 million, and cash dividends paid to stockholders of \$2.3 million.

**Contractual Obligations and Commitments**

The following table provides a summary of our contractual obligations and commitments as of December 31, 2013:

*(in thousands)*

|   | <b>Payments Due by Period:</b> |                         |                  |                  |                          |
|---|--------------------------------|-------------------------|------------------|------------------|--------------------------|
|   | <b>Total</b>                   | <b>Less than 1 year</b> | <b>1-3 years</b> | <b>3-5 years</b> | <b>More than 5 years</b> |
| Note payable                                    | \$ 15,000                      | \$ 4,980                | \$ 10,020        | \$-              | \$-                      |
| CLO I Notes due 2021                            | 431,003                        | -                       | -                | -                | 431,003                  |
| CLO II Notes due 2016-2023                      | 320,000                        | -                       | 3,800            | -                | 316,200                  |
| Contractual interest payments (1)               | 6,766                          | 3,870                   | 2,896            | -                | -                        |
| Operating lease obligations                     | 18,826                         | 4,082                   | 8,139            | 5,701            | 904                      |
| Purchase obligations                            | 70                             | 65                      | 5                | -                | -                        |
| Commitments to lend (2)                         | 25,614                         | 25,614                  | -                | -                | -                        |
| Commitments under standby letters of credit (3) | 248                            | 248                     | -                | -                | -                        |
| <b>Total payments</b>                           | <b>\$817,527</b>               | <b>\$38,859</b>         | <b>\$24,860</b>  | <b>\$5,701</b>   | <b>\$748,107</b>         |

- (1) Estimated future interest payments related to note payable and CLO Notes based on applicable interest rates as of December 31, 2013.
- (2) Unsettled trades to purchase loans at JMP Credit. The funds for such unsettled trades are included in restricted cash on the Consolidated Statement of Financial Condition at December 31, 2013.  
Conditional commitments issued by JMP Credit to guarantee the performance by a borrower to a third party. The
- (3) cash collateral supporting these standby letters of credit is included in restricted cash on the Consolidated Statement of Financial Condition at December 31, 2013.

## **Off-Balance Sheet Arrangements**

In connection with the CLOs, the Company had unfunded commitments to lend of \$40.4 million and \$18.6 million and standby letters of credit of \$1.8 million and \$1.0 million as of December 31, 2013 and 2012, respectively. These commitments do not extend to JMP Group Inc.

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 December 31, 2013. However, as described below under "Quantitative and Qualitative 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.

## **Critical Accounting Policies and Estimates**

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

Our significant accounting policies are summarized in Note 2 to our consolidated financial statements included elsewhere in this Annual Report on Form 10-K. On an ongoing basis, we evaluate our estimates and assumptions, particularly as they relate to accounting policies that we believe are most important to the presentation of our financial condition and results of operations. We regard an accounting estimate or assumption to be most important to the presentation of our financial condition and results of operations where:

- the nature of the estimate or assumption is material due to the level of subjectivity and judgment necessary to account for highly uncertain matters or the susceptibility of such matters to change; and
- the impact of the estimate or assumption on our financial condition or operating performance is material.

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

#### *Valuation of Financial Instruments*

The Company measures fair value in accordance with generally accepted accounting principles and expands disclosures with respect to fair value measurements. The 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 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. Small business loans (through the deconsolidation of HCC at May 2, 2013) are stated at fair value, with related changes in unrealized appreciation or depreciation reflected in the line item Gain on sale, payoff and mark-to-market of loans in the accompanying Consolidated Statements of Operations.

Fair value of our financial instruments is generally obtained from quoted market prices, third-party pricing services, or alternative pricing methodologies that we believe offer reasonable levels of price transparency. Valuations obtained from pricing services are considered reflective of executable prices. Data obtained from multiple sources are compared for consistency and reasonableness. 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 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 include investments in private investment funds managed by us or our affiliates, as well as cash paid for a subscription 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 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. 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.

In September 2009, the FASB issued amended accounting principles related to fair value measurements of investments in certain entities that calculate net asset value per share. The amended accounting principles permit, as a practical expedient, an entity to estimate the fair value of investments in certain entities using the net asset value per share of such entities. The Company estimates the fair value of its investments in private investment funds managed by third parties using the net asset value per share of those funds.

Also included in other investments are warrants on public and private common stock owned by JMP Securities and HCC LLC (through May 2, 2013), private equity securities owned by HGC, HGC II, HCC LLC (through May 2, 2013) and JMP Capital, the investments in private companies sponsored by JMP Group LLC (“JMPG LLC”) and JMP Capital, an interest rate cap derivative instrument, and a forward contract owned by HGC. 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 at JMP Securities 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. The fair value of the warrants and other equity securities owned by HCC LLC is determined by the Company using comparable public company metrics discounted for private company market illiquidity. The fair value of the private equity securities and the forward contract owned by HGC, HGC II and JMP Capital is determined by the Company using comparable public company metrics discounted for private company market illiquidity. The investments in private companies sponsored by JMPG LLC and JMP Capital are held using the equity method or fair value option.

The Company follows the authoritative guidance included in GAAP on the fair value option which provides companies with a choice 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.





The following tables summarize our marketable securities and other investments, as presented in our Consolidated Statements of Financial Condition, by valuation methodology as of December 31, 2013:

(in thousands)

|  | Other Investments (3)                            |   |                            |                              |  |                    |                   |                           |                         |   |
|--|--|---|----------------------------|------------------------------|--|--------------------|-------------------|---------------------------|-------------------------|---|
|  | Marketable Securities Owned, at Market Value (1) | Marketable Securities Sold, But Not Yet Purchased at Market Value (2) | Hedge Funds Managed by HCS | Fund of Funds Managed by HCS | Limited Partner in Private Equity Fund | Warrants and Other | Equity securities | Forward Purchase Contract | Total Other Investments | Total Marketable Securities and Other Investments |
| <b>Fair values based on:</b>                                     |  |   |                            |                              |  |                    |                   |                           |                         |   |
| Quoted market prices   | \$29,295   | \$13,749  | \$-                        | \$-                          | \$-                                    | \$-                | \$57              | \$-                       | \$57                    | \$43,101  |
| Black Scholes credit adjusted valuation                          | -  | -   | -                          | -                            | -                                      | -                  | -                 | -                         | -                       | -   |
| Black Scholes options valuation                                  | -  | -   | -                          | -                            | -                                      | 1,121              | -                 | -                         | 1,121                   | 1,121   |
| Observable market based inputs                                   | -  | -   | 44,548                     | -                            | -                                      | -                  | -                 | -                         | 44,548                  | 44,548  |
| Valuation determined by third party general partners             | -  | -   | -                          | 139                          | 5,967                                  | -                  | -                 | -                         | 6,106                   | 6,106   |
| Comparable public company metrics discounted for private company | -  | -   | -                          | -                            | -                                      | -                  | 100,871           | 6,864                     | 107,735                 | 107,735   |

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|  |          |          |          |       |         |         |           |         |           |           |     |   |      |   |     |   |       |   |       |   |
|--|----------|----------|----------|-------|---------|---------|-----------|---------|-----------|-----------|-----|---|------|---|-----|---|-------|---|-------|---|
| market illiquidity Totals                                | \$29,295 | \$13,749 | \$44,548 | \$139 | \$5,967 | \$1,121 | \$100,928 | \$6,864 | \$159,567 | \$202,611 |     |   |      |   |     |   |       |   |       |   |
| <b>Fair values based on:</b>                             |          |          |          |       |         |         |           |         |           |           |     |   |      |   |     |   |       |   |       |   |
| Quoted market prices                                     | 100.0    | %        | 100.0    | %     | 0.0     | %       | 0.0       | %       | 0.0       | %         | 0.0 | % | 0.0  | % | 0.0 | % | 0.0   | % | 21.2  | % |
| Black Scholes credit adjusted valuation                  | 0.0      | %        | 0.0      | %     | 0.0     | %       | 0.0       | %       | 0.0       | %         | 0.0 | % | 0.0  | % | 0.0 | % | 0.0   | % | 0.0   | % |
| Black Scholes options valuation                          | 0.0      | %        | 0.0      | %     | 0.0     | %       | 0.0       | %       | 0.0       | %         | 0.8 | % | 0.0  | % | 0.0 | % | 0.8   | % | 0.5   | % |
| Observable market based inputs                           | 0.0      | %        | 0.0      | %     | 27.9    | %       | 0.0       | %       | 0.0       | %         | 0.0 | % | 0.0  | % | 0.0 | % | 27.9  | % | 22.0  | % |
| Valuation determined by third party general partners     | 0.0      | %        | 0.0      | %     | 0.0     | %       | 0.1       | %       | 3.7       | %         | 0.0 | % | 0.0  | % | 0.0 | % | 3.8   | % | 3.0   | % |
| Comparable public company metrics                        | 0.0      | %        | 0.0      | %     | 0.0     | %       | 0.0       | %       | 0.0       | %         | 0.0 | % | 63.2 | % | 4.3 | % | 67.5  | % | 53.2  | % |
| discounted for private company market illiquidity Totals | 100.0    | %        | 100.0    | %     | 27.9    | %       | 0.1       | %       | 3.7       | %         | 0.8 | % | 63.2 | % | 4.3 | % | 100.0 | % | 100.0 | % |

(1) Marketable securities owned consist mainly of U.S. listed and OTC equity securities.

(2) Marketable securities sold, but not yet purchased consist mainly of U.S. listed and OTC equity securities.

Other investments consist of interests in hedge funds and funds of funds managed by HCS, limited partnership (3) interests in private investment funds managed by third parties that invest in predominately private securities and warrants in public and private common stock.

*Asset Management Investment Partnerships*

Investments in partnerships include our general partnership and limited partnership interests in investment partnerships, managed by our asset management subsidiary. Such investments are accounted for under the equity method based on our proportionate share of the earnings (or losses) of the investment partnership. 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 asset management subsidiary 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, as required by GAAP, if there are third-party transactions evidencing a change in value. Downward adjustments are also made, in the absence of third-party transactions, if the general partner determines that the expected realizable value of the investment is less than the carrying value.

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

We are also entitled to receive incentive fee allocations from the investment partnerships when the return exceeds 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 recorded at their fair value as of the acquisition date, which then becomes the new basis of the loans. Any unamortized deferred fees or costs that existed prior to the acquisition are written off at that date.

For those loans acquired with evidence of deterioration of credit quality since origination, the total discount from unpaid principal balance to fair value consists of a non-accretable credit discount and an accretable liquidity discount. The accretable portion of the discount is recognized in interest income as an adjustment to the yield of the loan over the contractual life of the loan using the interest method.

For those loans without evidence of deterioration in credit quality since origination, any difference between the Company's initial investment in the loan and its par value is recorded as a premium or discount, which is amortized or accreted into interest income as a yield adjustment over the contractual life of the loan using the effective interest method, in accordance with *ASC 310-20, Nonrefundable Fees and Other Costs*.



The Company reviews its loan portfolio at the end of each quarter to identify specific loss reserves on impaired loans or to record losses inherent in the homogenous loan portfolio. As loans collateralizing asset-backed securities issued are considered similar in nature, given the loan terms, ratings and average life expectancy, they are reviewed collectively in the quarterly assessment of loan loss reserves. Even when there are no credit losses identified in any individual loans, experience indicates there are losses inherent in the pooled loan portfolios as of the balance sheet date. The Company uses its loan loss model to estimate the unidentified losses that are inherent in the portfolio as of the balance sheet date and records provisions to its allowance for loan losses quarterly.

For loans acquired at a discount that are not accounted for under ASC 310-30, the allowance for loan losses recorded subsequent to the date of the loan acquisition is determined using the guidance in ASC 450. No allowance on these loans will be recognized until the current book value is accreted past the level of incurred loss. For loans acquired at a premium, the allowance for loan losses recorded subsequent to the date of the loan acquisition is determined in accordance with ASC 450, based on the contractual principal balances. Given the existence of the premium on these loans, the allowance recorded subsequent to acquisition is based on the Company's quarterly allowance methodology and represents losses inherent in the homogeneous loan portfolio at the balance sheet date. Accordingly, if the Company were to acquire loans at a premium during a particular period, the Company would record an allowance at the end of the quarter in which the loans were acquired.

Refer to "Allowance for Loan Losses" section below for the Company's quarterly assessment process.

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 non-accrual 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 non-accrual 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.

Restructured loans are considered a troubled debt restructuring ("TDR") if the Company, for economic or legal reasons related to the debtor's financial difficulties, grants a concession to the debtor that it would not otherwise consider. The Company may receive an asset from the debtor in a TDR, but the value of the asset received is typically significantly less than the amount of the debt forgiven. The Company has received equity interest in certain debtors as compensation for reducing the loan principal balance in some cases.

#### *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 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.

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 collectability of loans.

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") represent securities issued to third parties by CLO I and CLO II. The Company consolidated the CLOs for financial reporting purposes. At the acquisition date, the ABS at CLO I were recorded at fair value, which comprised the 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. At the

issuance date of the instrument, the Company made a policy election not to update the estimated life of the asset on a prospective basis. This conclusion established at the issuance date, was therefore fixed for the instrument.



### *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 authoritative guidance under GAAP on 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 recognizes deferred tax assets and liabilities in accordance with ASC 740, Income Taxes, and are determined based upon the temporary differences between the financial reporting and tax basis of the Company's assets and liabilities using the tax rates and laws in effect when the differences are expected to reverse. 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 applies the accounting principles related to uncertainty in income taxes. 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 authorities' 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.

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 tax.

## Recent Accounting Pronouncements

For a description of recent accounting pronouncements affecting the Company, refer to Note 3 in the accompanying consolidated financial statements.

## Item 7A. Quantitative and Qualitative Disclosures About Market Risk

### *Market Risk*

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

Even though we trade in equity securities as an active participant in both listed and OTC markets and we make markets in approximately 900 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 2012, we engaged in a forward contract derivative to secure the acquisition of certain private equity securities. In the future, we may utilize other hedging strategies such as equity derivative trades.

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 and Liquidity Risk*

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

Our marketable securities owned include long positions in equity securities that were recorded at a fair value of \$29.3 million as of December 31, 2013. Our marketable securities sold but not yet purchased consist of short positions in equity securities and were recorded at a fair value of \$13.7 million as of December 31, 2013. The net potential loss in fair value for our marketable equity securities portfolio as of December 31, 2013, using a hypothetical 10% decline in prices, is estimated to be approximately \$1.6 million. In addition, as of December 31, 2013, we have invested \$44.7 million of our own capital in our funds, which are invested primarily in publicly traded equity securities. The net potential loss in fair value for our investments at December 31, 2013, using a hypothetical 10% decline in the funds' investment portfolios, is estimated to be approximately \$4.5 million. A 10% decrease in the fair value of our investment in the equity securities in HGC, HGC II and JMP Capital is immaterial to the Company's results of operations due to the impact of the non-controlling interest holders. As of December 31, 2013, our interest in HGC and HGC II was 4.69% and 2.38%, respectively.

### *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. We believe we have mitigated our interest rate risk on our interest-sensitive liabilities, except liabilities of the CLOs, by entering into an interest rate cap through the maturity of these liabilities.

As of December 31, 2013, approximately 80.7% of our combined CLO portfolios had LIBOR floors with a weighted average floor of 1.06%. Many of the loans in CLO portfolios have variable interest rates indexed to LIBOR and subject to a LIBOR floor, which provides additional income during periods when LIBOR rates are below the floor levels. Loans with a LIBOR floor pay an interest rate of LIBOR plus the applicable margin so long as LIBOR remains above the specified floor level. If, however, LIBOR falls below the floor, the interest rate is the floor level plus the applicable margin. The asset backed securities issued by our CLOs typically have variable interest rates indexed to LIBOR, but do not have LIBOR floors. Accordingly, in a low interest rate environment, the equity holders of our CLOs benefit from a so called LIBOR floor benefit. If the LIBOR increases above the applicable LIBOR floors, the variable interest payments on the CLO asset backed securities will also increase, and the LIBOR floor benefit to us will decrease. This would diminish the return on equity of our CLOs that we hold, which could have an

adverse impact on our results of operations.

### *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.

## **Item 8. Financial Statements and Supplementary Data**

### **Management's Report on Internal Control Over Financial Reporting**

The management of JMP Group Inc. is responsible for establishing and maintaining adequate internal control over financial reporting to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external reporting purposes in accordance with U.S. generally accepted accounting principles.

Management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2013. This assessment was based on criteria for effective internal control over financial reporting described in "Internal Control—Integrated Framework (1992)," issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this assessment, management concluded that, as of December 31, 2013, the Company maintained effective internal control over financial reporting.

The effectiveness of the Company's internal control over financial reporting as of December 31, 2013, has been audited by PricewaterhouseCoopers LLP, the Company's independent registered public accounting firm, as stated in its report appearing on the following page, which expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of December 31, 2013.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of

JMP Group Inc.

In our opinion, the accompanying consolidated statements of financial condition and the related consolidated statements of operations, comprehensive income, changes in equity and cash flows present fairly, in all material respects, the financial position of JMP Group Inc. and its subsidiaries at December 31, 2013 and December 31, 2012, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2013, based on criteria established in Internal Control—Integrated Framework (1992) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express opinions on these financial statements and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

San Francisco, CA

March 13, 2014

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**JMP Group Inc.****Consolidated Statements of Financial Condition****(Dollars in thousands, except per share data)**

|  | <b>As of December 31,</b> |                  |
|--|---------------------------|------------------|
|  | <b>2013</b>               | <b>2012</b>      |
| <b>Assets</b>  |                           |                  |
| Cash and cash equivalents  | \$65,906                  | \$67,075         |
| Restricted cash and deposits (includes cash on deposit with clearing broker of \$150 at both December 31, 2013 and 2012) | 68,029                    | 69,813           |
| Receivable from clearing broker  | 1,280                     | 1,117            |
| Investment banking fees receivable, net of allowance for doubtful accounts of zero at December 31, 2013 and 2012         | 13,161                    | 5,148            |
| Marketable securities owned, at fair value   | 29,295                    | 14,347           |
| Incentive fee receivable   | 7,910                     | 2,945            |
| Other investments (includes \$161,518 and \$80,945 measured at fair value at December 31, 2013 and 2012, respectively)   | 161,773                   | 81,161           |
| Loans held for sale, at fair value   | -                         | 3,134            |
| Loans held for investment, net of allowance for loan losses  | 825                       | 150              |
| Small business loans, at fair value  | -                         | 38,934           |
| Loans collateralizing asset-backed securities issued, net of allowance for loan losses                                   | 727,270                   | 401,003          |
| Interest receivable  | 1,876                     | 1,229            |
| Fixed assets, net  | 2,092                     | 2,663            |
| Deferred tax assets  | 12,492                    | 13,087           |
| Other assets   | 30,022                    | 8,056            |
| <b>Total assets</b>  | <b>\$1,121,931</b>        | <b>\$709,862</b> |
| <b>Liabilities and Equity</b>  |                           |                  |
| <b>Liabilities:</b>  |                           |                  |
| Marketable securities sold, but not yet purchased, at fair value   | \$13,749                  | \$11,567         |
| Accrued compensation   | 51,347                    | 20,256           |
| Asset-backed securities issued   | 716,423                   | 415,456          |
| Interest payable   | 2,767                     | 588              |
| Note payable   | 15,000                    | 10,486           |
| Line of credit   | 2,895                     | 28,227           |
| Bond payable   | 46,000                    | -                |
| Deferred tax liability   | 3,625                     | 9,775            |
| Other liabilities  | 32,885                    | 26,203           |
| <b>Total liabilities</b>   | <b>884,691</b>            | <b>522,558</b>   |
| Redeemable Non-controlling Interest  | -                         | 161              |
| Commitments and Contingencies  |                           |                  |
| JMP Group Inc. Stockholders' Equity  |                           |                  |



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|   |             |           |
|---|-------------|-----------|
| Common stock, \$0.001 par value, 100,000,000 shares authorized; 22,780,052 shares issued at both December 31, 2013 and 2012; 21,819,446 and 22,591,649 shares outstanding at December 31, 2013 and 2012, respectively | 23          | 23        |
| Additional paid-in capital  | 132,547     | 128,318   |
| Treasury stock, at cost, 960,606 and 188,403 shares at December 31, 2013 and 2012, respectively   | (6,076 )    | (1,007 )  |
| Accumulated other comprehensive loss  | -           | (55 )     |
| Retained earnings (Accumulated deficit)   | (109 )      | (408 )    |
| Total JMP Group Inc. stockholders' equity   | 126,385     | 126,871   |
| Nonredeemable Non-controlling Interest  | 110,855     | 60,272    |
| Total equity  | 237,240     | 187,143   |
| Total liabilities and equity  | \$1,121,931 | \$709,862 |

See accompanying notes to consolidated financial statements

**JMP Group Inc.****Consolidated Statements of Financial Condition****(Dollars in thousands, except per share data)**

Assets and liabilities of consolidated variable interest entities (“VIE“) included in total assets and total liabilities above:

|  | <b>As of December 31,</b> |             |
|--|---------------------------|-------------|
|  | <b>2013</b>               | <b>2012</b> |
| Cash and cash equivalents  | \$211                     | \$-         |
| Restricted cash  | 43,497                    | 56,968      |
| Loans held for sale  | -                         | 3,134       |
| Loans collateralizing asset-backed securities issued, net of allowance for loan losses | 726,774                   | 401,003     |
| Interest receivable  | 1,851                     | 1,062       |
| Deferred tax assets  | 1,935                     | 3,387       |
| Other assets   | 3,602                     | 32          |
| Total assets of consolidated VIEs  | \$777,870                 | \$465,586   |
| Accrued Compensation   | 405                       | -           |
| Asset-backed securities issued   | 716,423                   | 415,456     |
| Note payable <sup>(1)</sup>  | 4,053                     | -           |
| Interest payable   | 1,947                     | 542         |
| Deferred tax liability   | 1,647                     | 8,437       |
| Other liabilities  | 882                       | 3,573       |
| Total liabilities of consolidated VIEs   | \$725,357                 | \$428,008   |

(1)December 31, 2013 balance inclusive of intercompany loan.

The asset-backed securities issued by the VIE are limited recourse obligations payable solely from cash flows of the loans collateralizing them and related collection and payment accounts pledged as security. Accordingly, the assets of the VIE can only be used to settle the obligations of the VIE.

See accompanying notes to consolidated financial statements



**JMP Group Inc.****Consolidated Statements of Operations****(In thousands, except per share data)**

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2013</b>                    | <b>2012</b> | <b>2011</b> |
| Revenues   |                                |             |             |
| Investment banking   | \$74,173                       | \$50,982    | \$46,114    |
| Brokerage  | 24,625                         | 21,903      | 25,461      |
| Asset management fees  | 25,952                         | 15,775      | 19,785      |
| Principal transactions   | 20,727                         | 10,537      | 1,615       |
| Gain on sale, payoff and mark-to-market of loans                               | 1,806                          | 7,255       | 16,997      |
| Net dividend income (loss)   | 535                            | (29 )       | 1,365       |
| Other income   | 798                            | 3,800       | 4,336       |
| Non-interest revenues  | 148,616                        | 110,223     | 115,673     |
| Interest income  | 33,346                         | 32,898      | 33,356      |
| Interest expense   | (30,110 )                      | (39,993 )   | (35,747 )   |
| Net interest income (expense)  | 3,236                          | (7,095 )    | (2,391 )    |
| Provision for loan losses  | (2,637 )                       | (2,206 )    | (1,728 )    |
| Total net revenues after provision for loan losses                             | 149,215                        | 100,922     | 111,554     |
| Non-interest expenses  |                                |             |             |
| Compensation and benefits  | 102,432                        | 66,415      | 89,017      |
| Administration   | 8,660                          | 6,186       | 6,649       |
| Brokerage, clearing and exchange fees  | 3,543                          | 3,806       | 4,735       |
| Travel and business development  | 4,416                          | 3,387       | 3,681       |
| Communications and technology  | 3,534                          | 3,503       | 3,988       |
| Occupancy  | 3,245                          | 3,157       | 2,927       |
| Professional fees  | 3,953                          | 3,630       | 2,955       |
| Depreciation   | 921                            | 884         | 721         |
| Impairment loss on purchased management contract                               | -                              | -           | 700         |
| Other  | 960                            | 420         | 426         |
| Total non-interest expenses  | 131,664                        | 91,388      | 115,799     |
| Net income (loss) before income tax expense                                    | 17,551                         | 9,534       | (4,245 )    |
| Income tax expense (benefit)   | 3,950                          | 1,581       | (1,632 )    |
| Net income (loss)  | 13,601                         | 7,953       | (2,613 )    |
| Less: Net income (loss) attributable to nonredeemable non-controlling interest | 9,973                          | 5,196       | (157 )      |
| Net income (loss) attributable to JMP Group Inc.                               | \$3,628                        | \$2,757     | \$(2,456 )  |

Net income (loss) attributable to JMP Group Inc. per common share:

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|   |         |         |           |
|---|---------|---------|-----------|
| Basic                                       | \$0.16  | \$0.12  | \$(0.11 ) |
| Diluted                                     | \$0.16  | \$0.12  | \$(0.11 ) |
| Dividends declared per common share         | \$0.145 | \$0.135 | \$0.105   |
| Weighted average common shares outstanding: |         |         |           |
| Basic                                       | 22,158  | 22,582  | 22,118    |
| Diluted                                     | 23,317  | 22,906  | 22,118    |

See accompanying notes to consolidated financial statements

**JMP Group Inc.****Consolidated Statements of Comprehensive Income****(In thousands)**

|  | <b>Year Ended</b> |             |             |
|--|-------------------|-------------|-------------|
|  | <b>2013</b>       | <b>2012</b> | <b>2011</b> |
| Net income (loss)  | \$13,601          | \$7,953     | \$(2,613)   |
| Other comprehensive income (loss)  |                   |             |             |
| Unrealized gain (loss) on cash flow hedge, net of tax                      | 55                | 47          | (39 )       |
| Comprehensive income (loss)  | 13,656            | 8,000       | (2,652)     |
| Less: Comprehensive income (loss) attributable to non-controlling interest | 9,973             | 5,196       | (157 )      |
| Comprehensive income (loss) attributable to JMP Group Inc.                 | \$3,683           | \$2,804     | \$(2,495)   |

See accompanying notes to consolidated financial statements

**JMP Group Inc.****Consolidated Statements of Changes in Equity****(In thousands)**

|  | <b>JMP Group Inc. Stockholders' Equity</b> |               |                       |                        |  |   |  | <b>Total Equity</b> |
|--|--|---------------|-----------------------|------------------------|--|---|--|---------------------|
|  | <b>Common Stock Shares</b>                 | <b>Amount</b> | <b>Treasury Stock</b> | <b>Paid-In Capital</b> | <b>Retained Earnings (Accumulated Deficit)</b> | <b>Accumulated Other Comprehensive Loss</b> | <b>Non-redeemable Controlling Interest</b> |                     |
| <b>Balance, December 31, 2010</b>  | 22,070                                     | \$ 22         | \$(2,210 )            | \$ 128,151             | \$ 4,696                                       | \$ (63 )                                    | \$ 11,456                                  | \$ 142,052          |
| Net loss   | -  | -             | -                     | -                      | (2,456 )                                       | -   | (157 )                                     | (2,613 )            |
| Additonal paid-in capital - stock-based compensation                               | -  | -             | -                     | 804                    | -  | -   | -  | 804                 |
| Additonal paid-in capital - excess tax benefit related to stock-based compensation | -  | -             | -                     | (335 )                 | -  | -   | -  | (335 )              |
| Cash dividends paid to shareholders  | -  | -             | -                     | -                      | (2,332 )                                       | -   | -  | (2,332 )            |
| Purchases of shares of common stock for treasury                                   | -  | -             | (6,353 )              | -                      | -  | -   | -  | (6,353 )            |
| Reissuance of shares of common stock from treasury                                 | -  | -             | 5,552                 | 433                    | -  | -   | -  | 5,985               |
| Common stock issued  | 340  | 0             | -                     | 3,891                  | -  | -   | -  | 3,891               |
| Distributions to non-controlling interest holders                                  | -  | -             | -                     | -                      | -  | -   | (2,828 )                                   | (2,828 )            |
| Unrealized loss on cash flow hedge, net of tax                                     | -  | -             | -                     | -                      | -  | (39 )                                       | -  | (39 )               |
| Capital contributions from non-controlling interest holders (1)                    | -  | -             | -                     | -                      | -  | -   | 18,358                                     | 18,358              |
| <b>Balance, December 31, 2011</b>  | 22,410                                     | \$ 22         | \$(3,011 )            | \$ 132,944             | \$ (92 )                                       | \$ (102 )                                   | \$ 26,829                                  | \$ 156,590          |
| Net income   | -  | -             | -                     | -                      | 2,757  | -   | 5,196                                      | 7,953               |
| Additonal paid-in capital - stock-based compensation                               | -  | -             | -                     | (7,606 )               | -  | -   | -  | (7,606 )            |
|  | -  | -             | -                     | -                      | (3,073 )                                       | -   | -  | (3,073 )            |

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|  |        |       |            |           |          |         |           |           |
|--|--------|-------|------------|-----------|----------|---------|-----------|-----------|
| Cash dividends paid to shareholders  |        |       |            |           |          |         |           |           |
| Purchases of shares of common stock for treasury                                       | -      | -     | (5,649 )   | -         | -        | -       | -         | (5,649 )  |
| Reissuance of shares of common stock from treasury                                     | -      | -     | 7,653      | 240       | -        | -       | -         | 7,893     |
| Common stock issued  | 370    | 1     | -          | 2,740     | -        | -       | -         | 2,741     |
| Distributions to non-controlling interest holders                                      | -      | -     | -          | -         | -        | -       | (5,774 )  | (5,774 )  |
| Unrealized gain on cash flow hedge, net of tax   | -      | -     | -          | -         | -        | 47      | -         | 47        |
| Capital contributions from non-controlling interest holders (1)                        | -      | -     | -          | -         | -        | -       | 34,021    | 34,021    |
| <b>Balance, December 31, 2012</b>  | 22,780 | \$ 23 | \$(1,007 ) | \$128,318 | \$(408 ) | \$(55 ) | \$60,272  | \$187,143 |
| Net income   | -      | -     | -          | -         | 3,628    | -       | 9,973     | 13,601    |
| Additional paid-in capital - stock-based compensation                                  | -      | -     | -          | 4,148     | -        | -       | -         | 4,148     |
| Dividends and dividend equivalents declared on common stock and restricted stock units | -      | -     | -          | -         | (3,329 ) | -       | -         | (3,329 )  |
| Purchases of shares of common stock for treasury                                       | -      | -     | (5,783 )   | -         | -        | -       | -         | (5,783 )  |
| Reissuance of shares of common stock from treasury                                     | -      | -     | 714        | 81        | -        | -       | -         | 795       |
| Common stock issued  | -      | -     | -          | -         | -        | -       | -         | -         |
| Distributions to non-controlling interest holders                                      | -      | -     | -          | -         | -        | -       | (3,913 )  | (3,913 )  |
| Unrealized gain on cash flow hedge, net of tax   | -      | -     | -          | -         | -        | 55      | -         | 55        |
| Capital contributions from non-controlling interest holders                            | -      | -     | -          | -         | -        | -       | 67,712    | 67,712    |
| Deconsolidation of subsidiary (Note 2)   | -      | -     | -          | -         | -        | -       | (23,189 ) | (23,189 ) |
| <b>Balance, December 31, 2013</b>  | 22,780 | \$ 23 | \$(6,076 ) | \$132,547 | \$(109 ) | \$-     | \$110,855 | \$237,240 |

(1) Excludes \$50 thousand and \$111 thousand attributable to redeemable non-controlling interest for the years ended December 31, 2011 and 2012, respectively.



See accompanying notes to consolidated financial statements

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**JMP Group Inc.****Consolidated Statements of Cash Flows****(In thousands)**

|   | <b>Year Ended December 31,</b> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <b>2013</b>                    | <b>2012</b> | <b>2011</b> |
| <b>Cash flows from operating activities:</b>  |                                |             |             |
| Net income (loss)   | \$13,601                       | \$7,953     | \$(2,613 )  |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities:                                   |                                |             |             |
| Provision for doubtful accounts   | 2                              | -           | -           |
| Provision for loan losses   | 2,637                          | 2,206       | 1,728       |
| Accretion of deferred loan fees   | (1,795 )                       | (2,184 )    | (1,317 )    |
| Amortization of liquidity discount, net   | 14,867                         | 29,208      | 21,513      |
| Amortization of debt issuance costs   | 31                             | -           | -           |
| Amortization of original issue discount, related to CLO II  | 580                            | -           | -           |
| Interest paid in kind   | (485 )                         | (10 )       | (23 )       |
| Gain on sale and payoff of loans  | (1,806 )                       | (6,905 )    | (17,020 )   |
| Change in other investments:  |                                |             |             |
| Fair value  | (16,482 )                      | (5,262 )    | 409         |
| Incentive fees reinvested in general partnership interests  | (7,753 )                       | (4,253 )    | (6,414 )    |
| Change in fair value of small business loans  | (90 )                          | (340 )      | 46          |
| Realized gain on other investments  | (2,895 )                       | (3,046 )    | (793 )      |
| Impairment loss on purchased management contract  | -                              | -           | 700         |
| Depreciation and amortization of fixed assets   | 921                            | 884         | 721         |
| Stock-based compensation expense  | 5,371                          | 2,492       | 10,303      |
| Deferred income taxes   | (5,554 )                       | (341 )      | (5,635 )    |
| Net change in operating assets and liabilities:   |                                |             |             |
| (Increase) decrease in interest receivable  | (647 )                         | 106         | (195 )      |
| (Increase) decrease in receivables  | 7,070                          | (3,275 )    | 7,554       |
| (Increase) decrease in marketable securities  | (14,948 )                      | 9,962       | (561 )      |
| (Increase) decrease in restricted cash (excluding restricted cash reserved for lending activities), deposits and other assets | (3,364 )                       | 989         | 10,333      |
| Increase in marketable securities sold, but not yet purchased   | 2,182                          | 646         | 252         |
| Increase (decrease) in interest payable   | 2,179                          | (63 )       | 81          |
| Increase (decrease) in accrued compensation and other liabilities   | 38,417                         | (21,524 )   | (2,919 )    |
| Net cash provided by operating activities   | 32,039                         | 7,243       | 16,150      |
| <b>Cash flows from investing activities:</b>  |                                |             |             |
| Purchases of fixed assets   | (350 )                         | (1,262 )    | (1,525 )    |
| Purchases of other investments  | (76,450 )                      | (28,130 )   | (16,985 )   |
| Sales of other investments  | 13,580                         | 10,192      | 8,771       |
| Funding of loans collateralizing asset-backed securities issued   | (590,932)                      | (202,627)   | (245,907)   |
| Funding of small business loans   | (1,250 )                       | (36,693 )   | (8,000 )    |

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|  |           |           |           |
|--|-----------|-----------|-----------|
| Sale and payoff of small business loans                                    | -         | 6,128     | -         |
| Funding of loans held for investment                                       | (825 )    | 150       | -         |
| Sale and payoff of loans collateralizing asset-backed securities issued    | 220,122   | 184,082   | 229,626   |
| Principal receipts on loans collateralizing asset-backed securities issued | 49,324    | 39,383    | 28,475    |
| Principal receipts on loans held for investment                            | -         | -         | 1,290     |
| Net change in restricted cash reserved for lending activities              | 7,125     | (20,878 ) | (12,218 ) |
| Cash associated with consolidation / deconsolidation of subsidiaries       | (13,344 ) | -         | -         |
| Net cash used in investing activities                                      | (393,000) | (49,655 ) | (16,473 ) |

See accompanying notes to consolidated financial statements

**JMP Group Inc.****Consolidated Statements of Cash Flows—(Continued)**

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2013</b>                    | <b>2012</b> | <b>2011</b> |
| Cash flows from financing activities:  |                                |             |             |
| Proceeds from issuance of note payable   | 15,000                         | -           | -           |
| Proceeds from borrowing on line of credit  | 3,045                          | 40,127      | -           |
| Proceeds from bond issuance  | 46,000                         | -           | -           |
| Proceeds from issuance of asset-backed securities  | 311,562                        | -           | -           |
| Payments of debt issuance costs  | (1,694 )                       | -           | -           |
| Repayment of note payable  | (10,486 )                      | (8,736 )    | (6,987 )    |
| Repayment of line of credit  | (28,227 )                      | (11,900 )   | -           |
| Repayment of asset-backed securities issued  | (26,723 )                      | -           | -           |
| Dividends and dividend equivalents paid on common stock and RSUs   | (3,329 )                       | (3,072 )    | (2,333 )    |
| Purchases of shares of common stock for treasury   | (5,783 )                       | (5,649 )    | (6,353 )    |
| Capital contributions of redeemable non-controlling interest holders   | 134                            | 111         | 50          |
| Capital contributions of nonredeemable non-controlling interest holders  | 64,634                         | 34,017      | 18,358      |
| Distributions to non-controlling interest shareholders   | (3,913 )                       | (5,774 )    | (2,828 )    |
| Cash settlement of stock-based compensation  | (428 )                         | -           | -           |
| Excess tax benefit related to stock-based compensation   | -                              | -           | (335 )      |
| Net cash provided by (used in) financing activities  | 359,792                        | 39,124      | (428 )      |
| Net decrease in cash and cash equivalents  | (1,169 )                       | (3,288 )    | (751 )      |
| Cash and cash equivalents, beginning of period   | 67,075                         | 70,363      | 71,114      |
| Cash and cash equivalents, end of period   | \$65,906                       | \$67,075    | \$70,363    |
| Supplemental disclosures of cash flow information:   |                                |             |             |
| Cash paid during the period for interest   | \$11,560                       | \$6,156     | \$5,382     |
| Cash paid during the period for taxes  | \$6,912                        | \$16        | \$5,128     |
| Non-cash investing and financing activities:   |                                |             |             |
| Reissuance of shares of common stock from treasury related to vesting of restricted stock units and exercises of stock options | \$714                          | \$7,653     | \$2,332     |

See accompanying notes to consolidated financial statements

## JMP GROUP INC.

### Notes to Consolidated Financial Statements

December 31, 2013, 2012 and 2011

#### 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, California. The Company conducts its brokerage business through JMP Securities LLC (“JMP Securities”), its asset management business through Harvest Capital Strategies LLC (“HCS”) and HCAP Advisors LLC (“HCAP Advisors”), its corporate credit business through JMP Credit Corporation (“JMP Credit”) and JMP Credit Advisors LLC (“JMPCA”), and certain principal investments through JMP Capital LLC (“JMP Capital”). The above entities, other than HCAP Advisors, are wholly-owned subsidiaries. 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. From September 2011 through May 2013, the Company also conducted corporate credit business through partially owned Harvest Capital Credit LLC (“HCC LLC”). On December 18, 2012, HCAP Advisors was formed as a Delaware Limited Liability Company. Effective May 1, 2013, HCAP Advisors provides investment advisory services to Harvest Capital Credit Corporation (“HCC”). Through JMPCA, the Company manages Cratos CLO I Holdings, LLC (“CLO I”, “Cratos”), JMPCA CLO II Ltd (“CLO II”) and JMPCA CLO III Ltd (“CLO III”).

#### *Recent Transactions*

On April 3, 2013, entities sponsored by JMP Group Inc. priced a \$343.8 million collateralized loan obligation (“CLO”). The senior notes offered in this transaction (the “Secured Notes”) were issued by JMP Credit Advisors CLO II Ltd., a special purpose Cayman vehicle, and co-issued in part by CLO II, a special purpose Delaware vehicle, and were backed by a diversified portfolio of broadly syndicated leveraged loans. The Secured Notes were issued in multiple tranches and are rated by Standard & Poor’s Ratings Services and, in respect of certain tranches, Moody’s Investors Service, Inc. The Secured Notes were priced with a weighted average coupon of three-month LIBOR plus 1.86%. The Company, through a wholly-owned subsidiary, retained \$17.3 million of the subordinated notes of the issuer (the “Subordinated Notes”). The Subordinated Notes do not bear interest and are not rated. The transaction closed on April 30, 2013. The Company manages CLO II, and owns approximately 73% of the Subordinated Notes.

HCAP Advisors was formed on December 18, 2012. HCAP Advisors appointed JMP Group LLC as its Manager effective May 1, 2013, and began offering investment advisory services. The Company owns a 51% equity interest in

HCAP Advisors. HCAP Advisors borrowed \$2.5 million from JMP Capital, to be repaid in quarterly installments, commencing on the last business day of March 2015, with the last such installment due and payable on December 31, 2017. HCAP Advisors used these funds to pay the underwriters a portion of the sales load in the amount of \$2.5 million, related to the IPO of HCC. HCC is not obligated to repay the portion of the sales load paid by HCAP Advisors.

On December 11, 2013 CLO III closed on a \$100.0 million warehouse credit agreement with BNP Paribas. CLO III is a special purpose vehicle whose debt, upon funding, will be secured by a diversified portfolio of broadly syndicated leveraged loans. The warehouse has a twelve month revolving period. As of December 31, 2013, CLO III held a \$0.5 million loan in its portfolio; however, the entity had not yet issued asset-backed securities. Given the intent of the CLO III structure, the loan was included in the loans collateralizing asset-backed securities line item on the Consolidated Statements of Financial Condition.

On August 18, 2011, HCS formed HCC LLC to make direct investments in the form of subordinated debt and, to a lesser extent, senior debt and minority equity investments, in privately-held U.S. small to mid-size companies. On December 26, 2012, HCC filed a registration statement on Form N-2 with the SEC in connection with a proposed initial public offering as a Business Development Company (“BDC”) under the Investment Company Act of 1940. On April 25, 2013, HCC entered into an acquisition agreement with HCC LLC. Pursuant to this acquisition agreement, HCC acquired HCC LLC, and the holders of membership interests in HCC LLC received shares of HCC common stock in exchange for their interests in HCC LLC. In addition, the number of units underlying each warrant, and the exercise price thereof, were converted into its common stock equivalent. HCC engaged HCAP Advisors to act as its adviser. Subject to the overall supervision of the HCC independent board of directors, HCAP Advisors manages HCC’s day-to-day operations and provides investment advisory services. On May 2, 2013, HCC priced its initial public offering of 3.4 million shares of its common stock at a price of \$15.00 per share, raising \$51.0 million in gross proceeds. The underwriters of the offering were granted a 30-day option to purchase up to an additional 433,333 shares of common stock from the company. That option was exercised on May 15, 2013, raising an additional \$6.5 million. After the offering, the Company’s ownership of HCC was 11.6%.

The Company performed a consolidation analysis at the time of the offering. After the IPO, HCC’s equity was sufficient, the holders of the equity had the characteristics of a controlling financial interest, and the investors had proportionate voting rights. Therefore, the Company determined HCC would not be considered a VIE. The Company applied the voting model. At the time of the initial public offering, the governance structure of HCC was reorganized, which diluted the Company’s influence. For votes on matters related to the Company, such as the approval of the investment advisory agreement or the administration agreement, interested directors are excluded because they are “interested parties.” Due to the additional shares issued through HCC’s initial public offering, the Company’s consolidated direct ownership interest in HCC was reduced from 31.1% to 11.6%. The Company, therefore, did not have a majority voting interest, and consolidation was no longer appropriate. The Company accounts for its investment in HCC using the fair value option.

## 2. Summary of Significant Accounting Policies

### *Basis of Presentation*

These financial statements and accompanying notes present the consolidated financial condition of the Company as of December 31, 2013 and December 31, 2012. Consolidated results of operations, stockholders' equity and cash flows are presented for the Company for the years ended December 31, 2013, 2012 and 2011.

The consolidated accounts of the Company include the wholly-owned subsidiaries, JMP Securities, HCS, JMP Capital, JMP Credit, JMPCA, and the partially-owned subsidiaries Harvest Growth Capital LLC ("HGC") (effective April 1, 2010), Harvest Growth Capital II LLC ("HGC II") (effective October 1, 2012), HCC LLC (from August 18, 2011 through May 2, 2013), CLO I, CLO II (effective April 30, 2013), CLO III (effective December 11, 2013), and HCAP Advisors (effective May 1, 2013). All material intercompany accounts and transactions have been eliminated in consolidation.

The Company performs consolidation analyses on entities to identify VIEs and determine appropriate accounting treatment. An entity is considered a VIE and, therefore, would be subject to the consolidation provisions of ASC 810-10-15 if, by design, equity investors do not have 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.

JMPCA manages CLO I, CLO II and CLO III. The Company assesses whether the CLOs meet the definition of a VIE, and whether the Company qualifies as the primary beneficiary. CLOs determined not to meet the definition of a VIE are considered voting interest entities for which the voting rights are evaluated to determine if consolidation is necessary. CLO I and CLO II were determined to be VIEs and the Company, which manages the CLOs and owns approximately 94% and 73% of the subordinated notes in CLO I and CLO II, respectively, is deemed the primary beneficiary. As a result, the Company consolidates the assets and liabilities of the CLO securitization entities, and the underlying loans owned by the CLO entities 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 asset-backed securities issued. See Note 5 and Note 8 for information pertaining to the loans owned and ABS issued by the CLOs, respectively.

CLO III was determined not to be a VIE as of December 31, 2013, as the entity's equity was sufficient, the holders of the equity had the characteristics of a controlling financial interest, and the investors had proportionate voting rights. The Company assessed whether consolidation would be applicable using the voting model, with consideration to its ownership investment in CLO III, and the level of its influence. Due to JMPCA's 100% equity stake in the CLO and its management of the vehicle, the Company consolidates CLO III in its financial statements.

HCS currently manages several asset management funds, which are structured as limited partnerships, and is the general partner of each. The Company assesses whether these partnerships meet the definition of a VIEs in accordance with ASC 810-10-15-14, and whether the Company qualifies as the primary beneficiary. Funds determined not to meet the definition of a VIE are considered voting interest entities for which the rights of the limited partners are evaluated to determine if consolidation is necessary. Such guidance provides that the presumption that the general partner controls the limited partnership may be overcome if the limited partners have substantive kick-out rights. Except for HGC and HGC II, the partnership agreements for these 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 funds, and therefore does not consolidate them except for HGC and HGC II. The Company accounts for its investments in these non-consolidated funds under the equity method of accounting.

The limited liability agreements of HGC and HGC II do not provide for the right of the members to remove the manager by a simple majority vote of the non-affiliated members and therefore the manager (with a minority interest in the limited liability company) is deemed to control the funds. As a result we consolidated HGC from its inception on April 1, 2010 and HGC II from its inception on October 1, 2012.

The Company performed the consolidation analysis for HCAP Advisors, and concluded it was a VIE, based on insufficient equity at risk. As a result, the Company is considered the primary beneficiary and consolidates the assets and liabilities.

#### *Use of Estimates*

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") 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 not likely to be completed, deferred expenses related to that transaction are expensed at that time. In connection with some underwritten transactions, the Company may hold in inventory, for a period of time, equity positions to facilitate the completion of the underwritten transactions. Realized and unrealized net gains and losses on these positions are recorded within investment banking revenues. Strategic advisory revenues primarily include success fees on closed merger and acquisition transactions, as well as retainer fees, earned in connection with advising on both buyers' and sellers' transactions. Fees are also earned for related advisory work and other services such as providing fairness opinions and valuation analyses. Strategic advisory revenues are recorded when the transactions or the services (or, if applicable, separate components thereof) to be performed are substantially complete, the fees are determinable and collection is reasonably assured. Private placement fees are related to non-underwritten transactions such as private placements of equity securities, PIPE, Rule 144A private offerings and trust preferred securities offerings, and are recorded on the closing date of the transaction. Un-reimbursed 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 collectability 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 for hedge funds, hedge funds of funds, private equity funds, HCC and New York Mortgage Trust (“NYMT”) 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 for hedge funds and hedge funds of funds are calculated at the investor level using their quarter-beginning capital balance adjusted for any contributions or withdrawals. Base management fees for private equity funds are calculated at the investor level using their aggregate capital commitments during the commitment period, which is generally three years from first closing, and on invested capital following the commitment period. Base management fees for HCC LLC are calculated based on the average value of our gross assets, reduced by the amount outstanding on its credit facility with JMP Group LLC, at the end of the two most recently completed calendar quarters. Refer to Note 7 for further information relating to this credit facility. The Company also earns incentive fees for hedge funds and hedge funds of funds 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, increased for contributions and decreased for withdrawals. Incentive fees are recognized as revenue at the end of the specified performance period. Generally, the performance period used to determine the incentive fee is quarterly for the hedge funds and NYMT, and annually for the hedge funds of funds managed by HCS. Generally, the incentive fees are reinvested in the investment funds in which the Company holds a general partner investment and withdrawn at the end of the year. The incentive fees are not subject to any contingent repayments to investors or any other clawback arrangements. Incentive fees for private equity funds and HCC LLC are based on a specified percentage of realized gains from the disposition of each portfolio investment in which each investor participates, and are earned by the Company after returning contributions by the investors for that portfolio investment and for all other portfolio investments in which each such investor participates that have been disposed of at the time of distribution. For both private equity funds and HCC LLC, fees are eliminated upon consolidation.

Asset management fees for the CLOs the Company managed through the year consisted of senior and subordinated base management fees. The Company recognizes base management fees for the CLOs on a monthly basis over the period in which the collateral management services are performed. The base management fees for the CLOs are

calculated as a percentage of the average aggregate collateral balances for a specified period. As the Company consolidates all of the CLOs, the management fees earned at JMPCA from the CLOs are eliminated upon consolidation in accordance with GAAP.

*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 clients, limited partner investments in private funds managed by third parties, and our investment in NYMT and HCC. Principal transaction revenues also include earnings (or losses) attributable to investment partnership interests managed by our asset management subsidiary, HCS, which are accounted for using the equity method of accounting. Principal transaction revenues also include unrealized gains and losses on the private equity securities owned by HGC and HGC II, private equity funds managed by HCS which is consolidated in our financial statements, as well as unrealized gains and losses on the investments in private companies sponsored by JMP Group LLC ("JMPG LLC") and JMP Capital.

The Company's principal transaction revenues for these categories for the years ended December 31, 2013, 2012 and 2011 are as follows:

| <i>(In thousands)</i>  | <b>Year Ended December</b> |             |             |
|--|----------------------------|-------------|-------------|
|  | <b>31,</b>                 |             |             |
|  | <b>2013</b>                | <b>2012</b> | <b>2011</b> |
| Equity and other securities excluding non-controlling interest | \$14,533                   | \$7,494     | \$1,339     |
| Warrants and other investments                                 | 2,200                      | 393         | (674 )      |
| Investment partnerships  | 3,994                      | 2,650       | 950         |
| Total principal transaction revenues                           | \$20,727                   | \$10,537    | \$1,615     |

*Gain on Sale, Payoff and Mark-to-market of Loans*

Gain on sale, payoff and mark-to-market of loans consists of gains from the sale and payoff of loans collateralizing asset-backed securities and loans held for sale at JMP Credit, and small business loans at HCC LLC (through May 2, 2013). This line item also includes lower of cost or market adjustments arising from loans held for sale and fair value adjustments to reflect the change in portfolio investment values at HCC LLC.

*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.

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, and the amortization of bond issuance costs. 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 CLO I. See *Asset-Backed Securities Issued* below 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 the financial institutions and assesses the credit risk of such investments.

### *Restricted Cash and Deposits*

Restricted cash and deposits include principal and interest payments that are collateral for the asset-backed securities issued by CLOs. 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 December 31, 2013 and 2012:

| <i>(In thousands)</i>   | <b>As of December</b> |                 |             |
|---|-----------------------|-----------------|-------------|
|   | <b>31,</b>            | <b>2013</b>     | <b>2012</b> |
| Principal and interest payments held as collateral for asset-backed securities issued | \$43,249              | \$56,720        |             |
| Cash collateral supporting standby letters of credit                                  | 248                   | 248             |             |
| Proceeds from short sales   | 13,749                | 11,567          |             |
| Deposit related to CLO III warehouse credit agreement                                 | 9,505                 | -               |             |
| Deposit with clearing broker  | 150                   | 150             |             |
| Deposits for operating leases   | 1,128                 | 1,128           |             |
|   | <b>\$68,029</b>       | <b>\$69,813</b> |             |

#### *Receivable from Clearing Broker*

The Company clears customer transactions through another broker-dealer on a fully disclosed basis. At both December 31, 2013 and December 31, 2012, 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. Investment banking fees receivable which are deemed to be uncollectible are charged off and the charge-off is deducted from the allowance. The allowance for doubtful accounts related to investment banking fees receivable were zero at December 31, 2013 and 2012.

#### *Fair Value of Financial Instruments*

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 4 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, asset-backed securities issued, are recorded at fair value or amounts that approximate fair value.

Marketable securities owned, other investments at fair value, 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, third-party pricing services, 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.

For disclosure purposes, the fair values for each of the loans held at CLO I, CLO II and CLO III were calculated using third-party pricing services. The average number of third-party pricing quotes received for CLO I, CLO II and CLO III were three, four and three, respectively, for December 31, 2013. Valuations obtained from third-party pricing services are considered reflective of executable prices. Data is obtained from multiple sources and compared for consistency and reasonableness.

Marketable securities owned and securities sold, but not yet purchased, consist of U.S. listed and over-the-counter ("OTC") equity securities. Other investments include investments in private investment funds managed by the Company and investments in private investment funds managed by third parties. 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. 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.

In September 2009, the FASB issued amended accounting principles related to fair value measurements of investments in certain entities that calculate net asset value per share. The amended accounting principles permit, as a practical expedient, an entity to estimate the fair value of investments in certain entities using the net asset value per share of such entities. The Company estimates the fair value of its investments in private investment funds managed

by third parties using the net asset value per share of those funds.

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Also included in other investments are warrants on public and private common stock owned by JMP Securities and HCC LLC, private equity securities owned by HGC, HGC II and JMP Capital, investments in private companies sponsored by JMPG LLC and JMP Capital. The warrants on public and private common stock are generally received in connection with investment banking transactions or origination of loans. Such warrants are fair valued at the date of issuance and marked-to-market as of each reporting period using the Black-Scholes Options Valuation methodology. HCC LLC values its investments for which market quotations are readily available from an independent pricing service or at the mean between the bid and ask prices obtained from at least two brokers or dealers (if available, otherwise by a principal market maker or a primary market dealer). HCC LLC engages independent valuation providers to review the valuation of each portfolio investment that does not have a readily available market quotation at least once quarterly. The fair value of the private equity securities owned by HGC, HGC II and JMP Capital is determined by the Company using comparable public company metrics discounted for private company market illiquidity. The interest rate cap derivative instrument fair value is determined from counterparty price quotations.

The Company follows the authoritative guidance included in GAAP on the fair value option which provides companies with a choice to report selected financial assets and financial liabilities at fair value. 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. The Company elected to apply the fair value option to the investments in HCC common stock. The primary reason for electing the fair value option was to measure these gains on our investments on the same basis as our other equity securities, all of which are stated at fair value.

In 2013, the Company recorded unrealized gains of \$20 thousand and \$0.5 million in net dividend income on the above investment in HCC. The gains on the investments in HCC are reported in Principal Transactions in the Consolidated Statements of Operation.

#### *Derivative Financial Instruments*

On May 29, 2010, the Company entered into an interest rate cap contract in order to hedge the interest rate exposure of its short-term and long-term borrowings. Such derivative financial instrument was recorded in the Consolidated Statements of Financial Condition at fair value. At the inception of the contract, the Company designated and documented the derivative contract as a hedge of a forecasted transaction or of the variability of cash flows to be received or paid related to a recognized asset or liability (“cash flow hedge”). For this cash flow hedge, the Company recorded changes in the fair value of this derivative to the extent that it is effective in other comprehensive (loss) income and subsequently reclassified these changes in fair value to net income in the same period(s) that the hedged transaction affects earnings. Such reclassification from other comprehensive income (loss) to earnings was recorded in the same financial statement category as the hedged item. The Company formally documented at inception its hedge relationships, including identification of the hedging instruments and the hedged items, its risk management objectives, strategy for undertaking the hedge transaction and the Company’s evaluation of effectiveness of its hedged transactions. Periodically, the Company also formally assessed whether the derivative designated in each hedging relationship was expected to be and had been highly effective in offsetting changes in cash flows of the hedged item

using the dollar offset method. On December 31, 2013, the interest rate cap expired.

The Company entered into a forward purchase contract to secure the acquisition of shares of a privately-held company. The contract and subsequent amendment incorporates downside protection for up to two years, for a cost basis of \$5.0 million. In January 2012, the Company exchanged \$5.0 million for physical custody of the shares. For two years beginning December 1, 2012, the Company could, at its discretion, become the beneficial and record holder of the shares. If the Company has not yet exercised its option at December 1, 2014, the shares will be assigned automatically to the Company. This contract is recorded in Other Investments in the Consolidated Statements of Financial Condition at fair value. The Company records changes in the fair value of this forward contract as unrealized gain or loss in Principal Transactions. Once the shares are in the Company's name, the shares will be accounted for as equity securities, remaining in Other Investments in the Consolidated Statements of Financial Condition.

#### *Fair Value Hierarchy*

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 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 generally 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 provides 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 levels of fair value hierarchy:

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.

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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 funds: determined by net asset value provided by third-party general partners;
  
- Warrants: JMP Securities investments determined by the Company using the Black-Scholes Options Valuation model;
  
- Warrants and Other: HCC LLC investments determined by the Company using public and private comparable transactions;
  - Private equity securities and forward purchase contract: HGC, HGC II and JMP Capital investment in private companies, determined by the Company using comparable public company metrics discounted for private company market illiquidity, and
  
- Small business loans: HCC LLC investments determined by the Company using discounted cash flow.

The Company's Level 3 assets consist primarily of private equity securities held by HGC, HGC II and JMP Capital. For investments acquired close to the valuation date, the Company uses the most recent purchase price to reflect the fair value of the investment. For all other investments, the Company determines fair value using a blended approach considering comparable public company metrics and comparable M&A transactions, discounted for private company market illiquidity. The Company applies the same valuation methodology to all HGC, HGC II, and JMP Capital private equity investments.

The valuations are reviewed and approved by the HGC Valuation Committee, which meets quarterly to discuss investment valuations and any significant or unusual events that have an impact on the valuation results. Fluctuations are generally driven by changes in peer public company performance, recent M&A activity, or revised financial information of the investee. The assumptions used in the valuation calculations (discounts, allocations, estimates, etc.) are assessed, with consideration to market and regulatory conditions, as well as company specific conditions, for events or circumstances that would indicate changes in the value. Peer companies are reviewed to determine whether the group selected remains appropriate, based on the market, customer, size, and growth rate.

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."

## *Loans*

Accounting guidance requires that the Company present and disclose certain information about its financing receivables by portfolio segment and/or by class of receivables. A portfolio segment is defined as the level at which an entity develops and documents a systematic methodology to determine the allowance for credit losses. A class of financing receivables is defined as the level of information (below a portfolio segment) that enables a reader to understand the nature and extent of exposure to credit risk arising from financing receivables. The Company's portfolio segments are loans held for sale, small business loans and loans collateralizing asset-backed securities issued. The Company has treated the loans held for investment as a single class given the small size of the respective loan portfolios as of December 31, 2013 and 2012. The classes within these portfolio segments are Asset Backed Loan ("ABL"), ABL – stretch, Cash Flow and Enterprise Value.

### *Loans Held for Sale*

Loans that the Company intends to sell in the foreseeable future are designated as loans held for sale. Once identified as such, the loans are recorded at the lower of cost or market. A quarterly evaluation is performed on a specific identification basis. The Company employs anticipated cash flows, discounted at an appropriate market credit adjusted interest rate to determine the fair value of the loans held for sale. Internally developed and third-party estimation tools are used to measure credit risk (loan ratings, probability of default, and exposure at default). An allowance is not recorded for loans held for sale as the determination of fair value incorporates the credit risk calculation. The adjustment to the lower of cost or market is recognized in the Consolidated Statements of Operations in the gain on sale, payoff and mark-to-market of loans. All loans held for sale are considered performing as of December 31, 2013 and 2012.

### *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, the Company establishes and maintains 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 for which the Company expects full principal payments may not be received. When loans are placed on non-accrual 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 non-accrual loans. The Company applies the above non-accrual policy consistently to all loans classified as loans held for investment without further disaggregation. Loans that are deemed to be uncollectible are charged off and the charged-off amount is deducted from the allowance.

### *Small Business Loans*

Small business loans represent the secured subordinated debt extended by HCC LLC to small to mid-sized companies. At inception, the loans were carried at the principal amount outstanding net of deferred fees, deferred costs and the allowance for loan losses. Changes to adopt investment company accounting were retrospectively applied and consolidated financial statements reflect the change in accounting principle as of 2011. HCC LLC reported all investments, including debt investments, at market value or, in the absence of a readily available market value, at fair value, with unrealized gains and losses recorded in Gain on sale, payoff and mark-to-market on the Consolidated Statements of Operations, until the deconsolidation of HCC LLC on May 2, 2013.

The Company accrues interest income it expects to ultimately collect. Generally, when an interest payment default occurs on a loan in the portfolio, or if management otherwise believes that the issuer of the loan will not be able to service the loan and other obligations, the Company will place the loan on non-accrual status and will cease recognizing interest income on that loan until all principal and interest is current through payment or until a restructuring occurs, such that the interest income is deemed collectible.

For loans with contractual payment-in-kind (“PIK”) interest income, which represents contractual interest accrued and added to the loan balance that generally becomes due at maturity, the Company will not accrue PIK interest if the portfolio company valuation indicates that such PIK interest is not collectible. Loan origination fees - net of direct loan origination costs, original issue discount and market discount or premium will be capitalized, and the Company accretes or amortizes such amounts using the effective interest method as interest income over the contractual life of the loan. Upon the prepayment of a loan or debt security, any unamortized net loan origination fee will be recorded as interest income. Loan exit fees that are contractually required to be paid at the termination or maturity of the loan will be accreted to interest income over the contractual term of the loan. The Company suspends the accretion of interest income for any loans or debt securities placed on non-accrual status. The Company may also collect other prepayment premiums on loans. These prepayment premiums are recorded as interest income.

### *Loans Collateralizing Asset-Backed Securities Issued*

Loans collateralizing asset-backed securities issued are recorded at their fair value as of the acquisition date, which then becomes the new basis of the loans. Any unamortized deferred fees or costs that existed prior to the acquisition are written off at that date.

For those loans acquired with evidence of deterioration of credit quality since origination, the total discount from unpaid principal balance to fair value consists of a non-accretable credit discount and an accretable liquidity discount. 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.

For those loans without evidence of deterioration in credit quality since origination, any difference between the Company's initial investment in the loan and its par value is recorded as a premium or discount, which is amortized or accreted into interest income as a yield adjustment over the contractual life of the loan using the effective interest method, in accordance with *ASC 310-20, Nonrefundable Fees and Other Costs*.

The Company reviews its loan portfolio at the end of each quarter to identify specific loss reserves on impaired loans or to record losses inherent in the homogenous loan portfolio. As loans collateralizing asset-backed securities issued are considered similar in nature, given the loan terms, ratings and average life expectancy, they are reviewed collectively in the quarterly assessment of loan loss reserves. Even when there are no credit losses identified in any individual loans, experience indicates there are losses inherent in the pooled loan portfolios as of the balance sheet date. The Company uses its loan loss model to estimate the unidentified losses that are inherent in the portfolio as of the balance sheet date and records provisions to its allowance for loan losses quarterly.

For loans acquired at a discount that are not accounted for under ASC 310-30, the allowance for loan losses recorded subsequent to the date of the loan acquisition is determined using the guidance in ASC 450. No allowance on these loans will be recognized until the current book value is accreted past the level of incurred loss. For loans acquired at a premium, the allowance for loan losses recorded subsequent to the date of the loan acquisition is determined in accordance with ASC 450, based on the contractual principal balances. Given the existence of the premium on these loans, the allowance recorded subsequent to acquisition is based on the Company's quarterly allowance methodology and represents losses inherent in the homogeneous loan portfolio at the balance sheet date. Accordingly, if the Company were to acquire loans at a premium during a particular period, the Company would record an allowance at the end of the quarter in which the loans were acquired.

Refer to "Allowance for Loan Losses" section below for the Company's quarterly assessment process.

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 non-accrual 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 non-accrual 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.





Restructured loans are considered a troubled debt restructuring (“TDR”) if the Company, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession to the debtor that it would not otherwise consider. The Company may receive an asset from the debtor in a TDR, but the value of the asset received is typically significantly less than the amount of the debt forgiven. The Company has received equity interest in certain debtors as compensation for reducing the loan principal balance in some cases.

#### *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 consists of two components: estimated loan losses for specifically identified loans and estimated loan losses inherent in the remainder of the portfolio. The Company’s loan portfolio consists primarily of loans made to small to middle market, privately owned companies. Loans made to these companies generally have higher risks compared to larger, publicly traded companies who have greater access to financial resources. 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. Given these considerations, the Company believes that it is necessary to reserve for estimated loan losses inherent in the portfolio.

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, the 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, the reduction is recognized as a specific reserve in accordance with the guidance 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 recorded 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. In addition, the Company provides an allowance on a loan by loan basis at JMP Credit for loans that 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 collectability of loans.

Loans are considered past due if the required principal and interest payment have not been received as of the date such payments were due. Loans or positions of loans that are deemed to be uncollectible are charged off and the charged-off amount is deducted from the allowance.

In determining the required allowance for loan losses inherent in the portfolio, the following factors are considered: 1) the expected loss severity rate for each class of loans, 2) the current Moody's Investors Service ("Moody's") rating and related probability of default, 3) the existing liquidity discount on the loans (when applicable), 4) internal loan ratings, and 5) loan performance.

Expected loss severity rate for each class of loans: The Company's loans are classified as either ABL, ABL – stretch, Cash Flow or Enterprise Value. The loss severity given a default is expected to be lowest on a conforming ABL loan, because the value of the collateral is typically sufficient to satisfy most of the amount owed. For ABL – stretch loans, the loss severity given a default is expected to be higher than for a conforming ABL loan because of less collateral coverage. For Cash Flow loans, the loss severity given a default is expected to be higher than ABL stretch loans, since generally less collateral coverage is provided for this class of loans. For Enterprise Value loans, the loss severity given a default is expected to be the highest, assuming that if the obligor defaults there has probably been a significant loss of enterprise value in the business. Loss severity estimates take into consideration current economic conditions such as overall macroeconomic trends, the amount of liquidity in the market and the condition of the CLO market.

Moody's rating and related probability of default: Moody uses factors such as, but not limited to, the borrower's leverage, use of proceeds, cash flows, growth rate, industry condition, concentration of risks, EBITDA margins and others factors. The lower the rating a loan carries, the higher the risk. Moody's publishes a probability of default for each rating class based on historical loss experience with loans of similar credit quality, and taking into consideration current economic conditions such as industry default rates, the amount of liquidity in the market and other macroeconomic trends. The higher the loan is rated, the less probability there is of a default. The Company updates the Moody's rating assigned to a loan whenever Moody's changes its rating for the loan.

Existing liquidity discount on the loans: For non-impaired loans held at Cratos at the acquisition date, a liquidity discount was recorded to reflect the fair value of those loans. To the extent that the liquidity discount on a loan is greater than the component of the general reserve attributable to that loan, no general reserve is recorded. If the pooled reserve for a loan is greater than its liquidity discount, the amount by which it exceeds the liquidity discount will be included in the pooled reserve calculation.

Internal loan ratings for Loans collateralizing asset-backed securities issued and Loans held for sale: The Internal Rating System is an internal portfolio monitoring mechanism allowing the Company to proactively manage portfolio risk and minimize losses. In evaluating these loans, the Company uses five account rating categories: 1 through 5. Internal ratings of 1 and 2 indicate lower risks while ratings between 3 and 5 indicate higher risks. Internal ratings are updated at least quarterly. The following describes each of the Company's internal ratings:



- |   |  |
|---|--|
| 1 | Investment exceeding expectations and/or a capital gain is expected.                                   |
| 2 | Investment generally performing in accordance with expectations.                                       |
| 3 | Investment performing below expectations and requires closer monitoring.                               |
| 4 | Investment performing below expectations where a higher risk of loss exists.                           |
| 5 | Investment performing significantly below expectations where the Company expects to experience a loss. |

Performance ratings:

|                |                    |
|----------------|--------------------|
| Performing     | Non-impaired loans |
| Non-performing | Impaired loans     |

*Asset-Backed Securities Issued*

Asset-backed securities issued (“ABS”) represent securities issued to third parties by CLO I and CLO II. At the acquisition date, the ABS at CLO I were recorded at fair value, which comprised the principal balance outstanding less liquidity discount. The liquidity discount was amortized into interest expense over the original expected remaining lives of the ABS using the interest method. At the issuance date of the instrument, the Company made a policy election not to update the estimated life of the asset on a prospective basis. This conclusion established at the issuance date, was therefore fixed for the instrument.

As of December 31, 2013, CLO III was not yet funded. Upon funding, debt held at CLO III will be secured by a diversified portfolio of broadly syndicated leveraged loans.

*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 recognizes deferred tax assets and liabilities in accordance with ASC 740, Income Taxes, and are determined based upon the temporary differences between the financial reporting and tax basis of the Company's assets and liabilities using the tax rates and laws in effect when the differences are expected to reverse. 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 applies the accounting principles related to uncertainty in income taxes. 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 authorities' 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.

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 tax.

### *Stock-Based Compensation*

The Company recognizes compensation cost for stock-based awards at their fair value on the date of grant and records compensation expense over the service period for awards expected to vest. Such grants are recognized as expense, 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 or other quantitative models to calculate the fair value of option awards. The quantitative models require subjective assumptions regarding variables such as future stock price volatility, dividend yield and expected time to exercise, which greatly affect the calculated values.



The fair value of restricted stock units (“RSUs”) is determined based on the closing price of the underlying stock on the grant date, discounted for future dividends not expected to be paid on unvested units during the vesting period. If applicable, a liquidity discount for post-vesting transfer restrictions is also applied.

#### *Treasury Stock*

The Company accounts for treasury stock under the cost method, using an average cost flow assumption, and includes treasury stock as a component of shareholders’ 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.

### **3. Recent Accounting Pronouncements**

ASU 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, was issued to improve the reporting of reclassifications out of accumulated other comprehensive income of various components. The standard requires an entity to present either on the face of the statement where net income is presented or in the notes to the financial statements, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income. The adoption of ASU 2013-02 on January 1, 2013 did not have a material impact on its financial statement disclosures.

ASU 2013-11, *Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists* was issued to provide guidance on the presentation of unrecognized tax benefits and will better reflect the manner in which an entity settles at the reporting date any additional income taxes that would result from the disallowance of a tax position when net operating loss carryforwards, similar tax losses, or tax credit carryforwards exist. The Company does not believe the adoption of ASU 2013-11 on January 1, 2014 will have a material impact on its financial statement disclosures.

### **4. Fair Value Measurements**



The following tables provide fair value information related to the Company's financial instruments at December 31, 2013 and 2012:

| <i>(In thousands)</i>  | <b>At December 31, 2013</b> |                   |                  |                  |                    |
|--|-----------------------------|-------------------|------------------|------------------|--------------------|
|  | <b>Carrying Value</b>       | <b>Fair Value</b> |                  |                  | <b>Total</b>       |
|  |                             | <b>Level 1</b>    | <b>Level 2</b>   | <b>Level 3</b>   |                    |
| <b>Assets:</b>   |                             |                   |                  |                  |                    |
| Cash and cash equivalents  | \$65,906                    | \$65,906          | \$-              | \$-              | \$65,906           |
| Restricted cash and deposits   | 68,029                      | 68,029            | -                | -                | 68,029             |
| Marketable securities owned  | 29,295                      | 29,295            | -                | -                | 29,295             |
| Other investments  | 161,773                     | 57                | 49,389           | 112,072          | 161,518            |
| Loans held for investment, net of allowance for loan losses                            | 825                         | -                 | -                | 693              | 693                |
| Loans collateralizing asset-backed securities issued, net of allowance for loan losses | 727,270                     | -                 | 737,327          | -                | 737,327            |
| Long term receivable   | 1,152                       | -                 | -                | 1,364            | 1,364              |
| <b>Total assets:</b>   | <b>\$1,054,250</b>          | <b>\$163,287</b>  | <b>\$786,716</b> | <b>\$114,129</b> | <b>\$1,064,132</b> |
| <b>Liabilities:</b>  |                             |                   |                  |                  |                    |
| Marketable securities sold, but not yet purchased                                      | \$13,749                    | \$13,749          | \$-              | \$-              | \$13,749           |
| Asset-backed securities issued   | 716,423                     | -                 | 710,961          | -                | 710,961            |
| Note payable   | 15,000                      | -                 | 15,000           | -                | 15,000             |
| Line of credit   | 2,895                       | -                 | 2,895            | -                | 2,895              |
| Bond payable   | 46,000                      | -                 | 46,552           | -                | 46,552             |
| <b>Total liabilities:</b>  | <b>\$794,067</b>            | <b>\$13,749</b>   | <b>\$775,408</b> | <b>\$-</b>       | <b>\$789,157</b>   |

**At December 31, 2012****Carrying  
Value Fair Value***(In thousands)*

|  |                  | <b>Level 1</b>   | <b>Level 2</b>   | <b>Level 3</b>  | <b>Total</b>     |
|--|------------------|------------------|------------------|-----------------|------------------|
| <b>Assets:</b>   |                  |                  |                  |                 |                  |
| Cash and cash equivalents  | \$67,075         | \$67,075         | \$-              | \$-             | \$67,075         |
| Restricted cash and deposits   | 69,813           | 69,813           | -                | -               | 69,813           |
| Marketable securities owned  | 14,347           | 14,347           | -                | -               | 14,347           |
| Other investments  | 81,161           | 865              | 28,137           | 51,943          | 80,945           |
| Loans held for investment, net of allowance for loan losses                            | 150              | -                | -                | 150             | 150              |
| Loans held for sale  | 3,134            | -                | 3,134            | -               | 3,134            |
| Small business loans   | 38,934           | -                | 3,487            | 35,447          | 38,934           |
| Loans collateralizing asset-backed securities issued, net of allowance for loan losses | 401,003          | -                | 406,313          | 5,716           | 412,029          |
| Long term receivable   | 1,342            | -                | -                | 1,647           | 1,647            |
| <b>Total assets:</b>   | <b>\$676,959</b> | <b>\$152,100</b> | <b>\$441,071</b> | <b>\$94,903</b> | <b>\$688,074</b> |
| <b>Liabilities:</b>  |                  |                  |                  |                 |                  |
| Marketable securities sold, but not yet purchased                                      | \$11,567         | \$11,567         | \$-              | \$-             | \$11,567         |
| Asset-backed securities issued   | 415,456          | -                | 404,341          | -               | 404,341          |
| Note payable   | 10,486           | -                | 10,486           | -               | 10,486           |
| Line of credit   | 28,227           | -                | 28,227           | -               | 28,227           |
| <b>Total liabilities:</b>  | <b>\$465,736</b> | <b>\$11,567</b>  | <b>\$443,054</b> | <b>\$-</b>      | <b>\$454,621</b> |

*Recurring Fair Value Measurement*

The following tables provide information related to the Company's assets and liabilities carried at fair value on a recurring basis at December 31, 2013 and 2012:

*(In thousands)***December 31, 2013****Level 1 Level 2 Level 3 Total**

|   |                 |                 |                  |                  |
|---|-----------------|-----------------|------------------|------------------|
| Marketable securities owned                       | \$29,295        | \$-             | \$-              | \$29,295         |
| <b>Other investments:</b>                         |                 |                 |                  |                  |
| Investments in hedge funds managed by HCS         | -               | 44,647          | -                | 44,647           |
| Investments in funds of funds managed by HCS      | -               | -               | 139              | 139              |
| <b>Total investment in funds managed by HCS</b>   | <b>-</b>        | <b>44,647</b>   | <b>139</b>       | <b>44,786</b>    |
| Investments in private equity/ real estate funds  | -               | -               | 5,967            | 5,967            |
| Warrants and other held at JMPS and JMPG LLC      | -               | -               | 1,121            | 1,121            |
| Equity securities in HGC, HGC II and JMP Capital  | 57              | 4,742           | 97,981           | 102,780          |
| Forward purchase contract                         | -               | -               | 6,864            | 6,864            |
| <b>Total other investments</b>                    | <b>57</b>       | <b>49,389</b>   | <b>112,072</b>   | <b>161,518</b>   |
| <b>Total assets:</b>                              | <b>\$29,352</b> | <b>\$49,389</b> | <b>\$112,072</b> | <b>\$190,813</b> |
| Marketable securities sold, but not yet purchased | 13,749          | -               | -                | 13,749           |

|                           |          |     |     |          |
|---------------------------|----------|-----|-----|----------|
| <b>Total liabilities:</b> | \$13,749 | \$- | \$- | \$13,749 |
|---------------------------|----------|-----|-----|----------|

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*(In thousands)***December 31, 2012**

|   | <b>Level 1</b>  | <b>Level 2</b>  | <b>Level 3</b>  | <b>Total</b>     |
|---|-----------------|-----------------|-----------------|------------------|
| Marketable securities owned                       | \$14,347        | \$-             | \$-             | \$14,347         |
| Small business loans                              | -               | 3,487           | 35,447          | 38,934           |
| Other investments:                                |                 |                 |                 |                  |
| Investments in hedge funds managed by HCS         | -               | 27,907          | -               | 27,907           |
| Investments in funds of funds managed by HCS      | -               | -               | 109             | 109              |
| Total investment in funds managed by HCS          | -               | 27,907          | 109             | 28,016           |
| Investment in private equity fund                 | -               | -               | 2,332           | 2,332            |
| Warrants and other held at JMPS                   | -               | -               | 413             | 413              |
| Warrants and equity securities held at HCC LLC    | -               | -               | 2,577           | 2,577            |
| Equity securities in HGC, HGC II and JMP Capital  | 865             | 230             | 41,075          | 42,170           |
| Forward purchase contract                         | -               | -               | 5,437           | 5,437            |
| Total other investments                           | 865             | 28,137          | 51,943          | 80,945           |
| <b>Total assets:</b>                              | <b>\$15,212</b> | <b>\$31,624</b> | <b>\$87,390</b> | <b>\$134,226</b> |
| Marketable securities sold, but not yet purchased | 11,567          | -               | -               | 11,567           |
| <b>Total liabilities:</b>                         | <b>\$11,567</b> | <b>\$-</b>      | <b>\$-</b>      | <b>\$11,567</b>  |

The Company holds a limited partner investment in a private equity fund. This fund aims to achieve medium to long-term capital appreciation by investing in a diversified portfolio of technology companies that leverage the growth of Greater China. The Company also holds an investment in a real estate fund, which aims to generate revenue stream from investments in real estate joint ventures.

The Company's Level 2 assets held in other investments consist of small business loans (through May 2, 2013), investments in hedge funds managed by HCS, and equity securities in HGC, HGC II, and JMP Capital. The fair value of the Level 2 small business loans is calculated using the average market bid and ask quotation obtained from a loan pricing service. The fair value of the investment in hedge funds is calculated using the net asset value. These assets are considered Level 2, as the underlying hedge funds are mainly invested in publicly traded stocks whose value is based on quoted market prices. The Level 2 equity securities in HGC, HGC II, and JMP Capital reflect investments in public securities, where the Company is subject to a lockup period. The fair value of the Level 2 equity securities in HGC, HGC II and JMP Capital is calculated by applying a discount rate to the quoted market prices of the portfolio securities due to lack of marketability.

The following tables provide a reconciliation of the beginning and ending balances for the assets measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the years ended December 31, 2013 and 2012:

*(In thousands)***Purchases Sales Settlements**

|  | <b>Balance as of December 31, 2012</b> |           |          |           | <b>Total gains (losses) - realized and unrealized included in earnings (1)</b> | <b>Transfers in/(out) of Level 3</b> | <b>Balance as of December 31, 2013</b> | <b>Unrealized gains/(losses) included in earnings related to assets still held at reporting date</b> |
|--|--|-----------|----------|-----------|--|--------------------------------------|--|--|
| Investments in funds of funds managed by HCS Limited partner investment in private equity fund | \$ 109                                 | \$ -      | \$ -     | \$ -      | \$ 30  | \$ -                                 | \$ 139                                 | \$ 30  |
| Warrants and other held at JMPS  | 2,332                                  | 3,009     | -        | (658 )    | 1,284  | -                                    | 5,967                                  | 1,284  |
| Warrants and equity held at HCC LLC  | 413                                    | 42        | (206)    | -         | 872  | -                                    | 1,121                                  | 784  |
| Small business loans   | 2,577                                  | 100       | -        | -         | 425  | (3,102 )                             | -                                      | -  |
| Equity securities held by HGC, HGC II and JMP Capital  | 35,447                                 | 1,771     | (43 )    | -         | 30   | (37,205 )                            | -                                      | -  |
| Forward Purchase Contract  | 41,075                                 | 50,622    | -        | -         | 17,119   | (10,835 )                            | 97,981                                 | 17,119   |
| Total Level 3 assets   | \$ 87,390                              | \$ 55,544 | \$ (249) | \$ (658 ) | \$ 21,187  | \$ (51,142 )                         | \$ 112,072                             | \$ 20,644  |

(1) No Level 3 asset gains (losses) are included in other comprehensive income. All realized and unrealized gains (losses) related to Level 3 assets are included in earnings.

| <i>(In thousands)</i>                                 | <b>Balance<br/>as of<br/>December<br/>31, 2011</b> | <b>Purchases</b> | <b>Sales</b>     | <b>Settlements</b> | <b>Total<br/>gains<br/>(losses) -<br/>realized<br/>and<br/>unrealized<br/>included<br/>in<br/>earnings<br/>(1)</b> | <b>Transfers<br/>in/(out)<br/>of Level<br/>3</b> | <b>Balance<br/>as of<br/>December<br/>31, 2012</b> | <b>Unrealized<br/>gains/(losses)<br/>included<br/>in<br/>earnings<br/>related to<br/>assets still<br/>held at<br/>reporting<br/>date</b> |
|---|--|------------------|------------------|--------------------|--|--|--|--|
| Investments in funds of funds managed by HCS          | \$ 102   | \$ -             | \$ -             | \$ -               | \$ 7   | \$ -   | \$ 109   | \$ 7   |
| Limited partner investment in private equity fund     | 2,585  | 25               | -                | (49 )              | (229 )   | -  | 2,332  | (229 )   |
| Warrants and other held at JMPS                       | 617  | 20               | -                | -                  | (224 )   | -  | 413  | (112 )   |
| Warrants and equity held at HCC                       | -  | 946              | -                | -                  | 1,631  | -  | 2,577  | 1,631  |
| Small business loans                                  | 3,902  | 34,823           | (3,673)          | -                  | 395  | -  | 35,447   | 217  |
| Equity securities held by HGC, HGC II and JMP Capital | 20,707   | 20,000           | -                | -                  | 1,581  | (1,213 )   | 41,075   | 1,581  |
| Forward Purchase Contract                             | -  | 5,000            | -                | -                  | 437  | -  | 5,437  | 437  |
| <b>Total Level 3 assets</b>                           | <b>\$ 27,913</b>                                   | <b>\$ 60,814</b> | <b>\$(3,673)</b> | <b>\$ (49 )</b>    | <b>\$ 3,598</b>  | <b>\$(1,213 )</b>                                | <b>\$ 87,390</b>                                   | <b>\$ 3,532</b>  |

(1) No Level 3 asset gains (losses) are included in other comprehensive income. All realized and unrealized gains (losses) related to Level 3 assets are included in earnings.

Purchases and sales of Level 3 assets shown above were recorded at fair value at the date of the transaction.

Total gains and losses included in earnings 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.

Transfers between levels of the fair value hierarchy result from changes in the observability of fair value inputs used in determining fair values for different types of financial assets and are recognized at the beginning of the reporting period in which the event or change in circumstances that caused the transfer occurs.

There was one transfer into Level 1 for the year ended December 31, 2013, as a result of the expiration of the lockup discount on the Company's investment in HCC. There were transfers into Level 2 from Level 3 of \$3.7 million during the year ended December 31, 2013, as a result of the observability of fair value associated with the equity securities in HGC. In connection with the acquisition, the Company exchanged \$7.1 million of its Level 3 assets for shares of the acquiring public company. This exchange is reflected in the transfers column within the Level 3 asset rollforward. The new shares are Level 2 assets as of December 31, 2013, to reflect the associated lockup discount.

The deconsolidation of HCC LLC resulted in the exclusion of \$3.1 million warrants and other equity and \$37.2 million in small business loans from the Company's Level 3 assets.

There were no transfers in/out of Level 1 during the year ended December 31, 2012. Transfers into Level 2 from Level 3 were \$1.2 million during the year ended December 31, 2012. These transfers were a result of the initial public offerings of two investments in HGC. One investment was subsequently transferred into Level 1 from Level 2 during the year ended December 31, 2012, reflecting the fair value measurement of the investment being based on quoted market prices without further adjustment.

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 are reported in Principal Transactions in the accompanying Consolidated Statements of Operations.

Included in other investments are investments in partnerships in which one of the Company's subsidiaries is the investment manager and general partner. The Company accounts for these investments using the equity method as described in Note 2 - Summary of Significant Accounting Policies. The Company's proportionate share of those investments is included in the tables above. In addition, other investments include warrants and investments in funds managed by third parties. The investments in private investment funds managed by third parties are generally not redeemable at the option of the Company. As of December 31, 2013, the Company had unfunded investment commitments of \$0.1 million related to private investment funds managed by third parties.

The Company used the following valuation techniques with unobservable inputs when estimating the fair value of the Level 3 assets:

| <i>Dollars in thousands</i>                             | <b>Fair Value<br/>at<br/>December<br/>31, 2013</b> | <b>Valuation<br/>Technique</b> | <b>Unobservable<br/>Input</b>      | <b>Range<br/>(Weighted Average)</b> |
|---|--|--------------------------------|------------------------------------|-------------------------------------|
| Investments in Funds of Funds managed by HCS (1)        | \$ 139   | Net Asset Value                | N/A                                | N/A                                 |
| Limited Partner in Private Equity /Real Estate Fund (1) | \$ 5,967   | Net Asset Value                | N/A                                | N/A                                 |
| Warrants and Other held at JMPS and JMPG LLC            | \$ 1,121   | Black-Scholes Option Model     | Annualized volatility of credit    | 15.4 - 25.4% (13.4%)                |
| Equity securities in HGC, HGC II and JMP Capital (2)    | \$ 97,981  | Market comparable companies    | Revenue multiples                  | 2.4x - 14.5x (6.3x)                 |
|   |  |                                | EBITDA multiples                   | 14.9x - 31.9x (22.1x)               |
|   |  | (3)                            | Discount for lack of marketability | 30% - 40% (32%)                     |
|   |  | Market transactions            | Revenue multiples                  | 3.4x - 7.6x (5.7x)                  |
|   |  |                                | EBITDA multiples                   | 11.8x - 26.6x (17.7x)               |
|   |  |                                | Control premium                    | 25%                                 |
| Forward purchase contract (2)                           | \$ 6,864   | Market comparable companies    | Revenue multiples                  | 10.6x - 14.5x (12.3x)               |
|   |  | (3)                            | Billing multiples                  | 8.7x - 11.6x (10.0x)                |
|   |  |                                | Discount for lack of marketability | 30%                                 |
|   |  | Market transactions            | Revenue multiples                  | 7.0x                                |
|   |  |                                | Control premium                    | 25%                                 |

(1) The Company uses the reported net asset value per share as a practical expedient to estimate the fair value of the investments in funds of funds managed by HCS and limited partner investment in private equity funds.

(2) The fair value of each HGC, HGC II and JMP Capital investment is calculated using a weighted allocation between the fair values assessed by the public comparables and M&A comparable valuation techniques.



(3) The Company applies a discount for lack of marketability (“DLOM”) to its investments, ranging from 30% to 50%. The discount is determined by the level of revenue of the investee and proximity to filing. The minimum discount applied is 30% for investees that either generate revenue exceeding \$100 million, or have filed a registration statement. Higher discounts are applied to investees with less than \$100 million of revenue or that are not on file, reflecting the longer anticipated term to a liquidity event. When HGC and HGC II investments become public, the Company is typically subject to a lock up period. In valuing these public companies, the Company has incorporated 5% per month of lockup into its valuations. As the typical lockup period is six months, the DLOM methodology has a floor threshold of 30% to mirror the discount rates applied once the investment goes public.

The Company used the following valuation techniques with unobservable inputs when estimating the fair value of the Level 3 assets:

| <i>Dollars in thousands</i>                          | <b>Fair Value<br/>at<br/>December<br/>31, 2012</b> | <b>Valuation<br/>Technique</b> | <b>Unobservable<br/>Input</b>    | <b>Range<br/>(Weighted Average)</b> |
|--|--|--------------------------------|----------------------------------|-------------------------------------|
| Investments in Funds of Funds managed by HCS (1)     | \$ 109   | Net Asset Value                | N/A                              | N/A                                 |
| Limited Partner in Private Equity Fund (1)           | \$ 2,332   | Net Asset Value                | N/A                              | N/A                                 |
| Warrants and Other held at JMPS                      | \$ 413   | Black-Scholes Option Model     | Annualized volatility of credit  | 16.2% - 28.9% (16.8%)               |
| Warrants and equity held at HCC LLC                  | \$ 2,577   | Market comparable companies    | EBITDA multiples                 | 3.8x - 6.8x (8.5x)                  |
|  |  | Income                         | Weighted average cost of capital | 10.0% - 18.0% (15.6%)               |
| Small Business Loans (2)                             | \$ 35,447  | Bond yield                     | Risk adjusted discount factor    | 8.5% - 16.2% (13.2%)                |
|  |  | Market comparable companies    | EBITDA multiples                 | 3.8x - 6.8x (8.5x)                  |
|  |  | Income                         | Weighted average cost of capital | 10.0% - 18.0% (15.6%)               |
|  |  |                                | Expected principal recovery      | 0.0% - 100.0% (100.0%)              |
| Equity securities in HGC, HGC II and JMP Capital (3) | \$ 41,075  | Market comparable companies    | Revenue multiples                | 2.1x - 7.3x (3.5x)                  |
|  |  |                                | EBITDA multiples                 | 8.8x - 22.9x (15.8x)                |

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|                               |          |                                   |     |  |       |   |       |         |
|-------------------------------|----------|-----------------------------------|-----|--|-------|---|-------|---------|
|                               |          |                                   | (4) | Discount for<br>lack of<br>marketability | 30%   | - | 40%   | (34%)   |
|                               |          | Market<br>transactions            |     | Revenue<br>multiples                     | 3.2x  | - | 11.7x | (5.2x)  |
|                               |          |                                   |     | EBITDA<br>multiples                      | 11.7x | - | 19.8x | (15.4x) |
|                               |          |                                   |     | Control<br>premium                       |       |   | 25%   |         |
| Forward purchase contract (3) | \$ 5,437 | Market<br>comparable<br>companies |     | Revenue<br>multiples                     | 6.7x  | - | 8.1x  | (7.3x)  |
|                               |          |                                   |     | Billing multiples                        | 6.0x  | - | 7.2x  | (6.5x)  |
|                               |          |                                   | (4) | Discount for<br>lack of<br>marketability |       |   | 30%   |         |
|                               |          | Market<br>transactions            |     | Revenue<br>multiples                     |       |   | 6.3x  |         |
|                               |          |                                   |     | Control<br>premium                       |       |   | 25%   |         |

(1) The Company uses the reported net asset value per share as a practical expedient to estimate the fair value of the general partner investment in funds of funds and limited partner investment in mortgage and private equity funds.

(2) As of December 31, 2012, the fair value of every Level 3 HCC LLC small business loan was calculated using the bond yield method. The Company evaluated market comparables and used the results of the income approach as supplemental information to further support the estimated fair value.

(3) The fair value of each HGC, HGC II and JMP Capital investment is calculated using a weighted allocation between the fair values assessed by the public comparables and M&A comparable valuation techniques.

(4) The Company applies a discount for lack of marketability to its investments, ranging from 30% to 50%. The discount is determined by the level of revenue of the investee and proximity to filing. The minimum discount applied is 30% for investees that either generate revenue exceeding \$100 million, or have filed a registration statement. Higher discounts are applied to investees with less than \$100 million of revenue or that are not on file, reflecting the longer anticipated term to a liquidity event. When HGC and HGC II investments become public, the Company is typically subject to a lock up period. In valuing these public companies, the Company has incorporated 5% per month of lockup into its valuations. As the typical lockup period is six months, the DLOM methodology has a floor threshold of 30% to mirror the discount rates applied once the investment goes public.

The significant unobservable input used in the fair value measurement of the warrants held at JMP Securities is the annualized volatility of credit. Significant increases in the rate would result in a significantly higher fair value measurement.



The significant unobservable input used in the fair value measurement of the warrants and equity held at HCC LLC are EBITDA multiples and weighted average cost of capital. Significant increases in the multiples in isolation would result in a significantly higher fair value measurement. Increases in the discounts in isolation would result in decreases to the fair value measurement.

The significant unobservable input used in the fair value measurement of the small business loans held are risk adjusted discount factors, EBITDA multiples, weighted average cost of capital and expected principal recoveries. Significant increases in the multiples and expected principal recovery rates in isolation would result in a significantly higher fair value measurement. Increases in the discounts in isolation would result in decreases to the fair value measurement.

The significant unobservable inputs used in the fair value measurement of the equity securities and the forward contract in HGC, HGC II and JMP Capital are Revenue, EBITDA and Billing multiples, discount for lack of marketability, and control premiums. Significant increases in the multiples in isolation would result in a significantly higher fair value measurement. Increases in the discounts and premium in isolation would result in decreases to the fair value measurement.

#### *Nonrecurring Fair Value Measurements*

The following tables provide information related to the Company's assets carried at fair value on a non-recurring basis at December 31, 2013 and 2012:

|                       | <b>Fair Value</b> | <b>Gains (Losses)</b> |             |
|-----------------------|-------------------|-----------------------|-------------|
|                       |                   | <b>Year Ended</b>     |             |
|                       | <b>December</b>   | <b>December 31,</b>   |             |
| <i>(In thousands)</i> | <b>31,</b>        | <b>2013</b>           | <b>2012</b> |
|                       | <b>2013</b>       | <b>2013</b>           | <b>2012</b> |
| <b>Assets:</b>        |                   |                       |             |
| Nonaccrual loans      | \$- \$5,716       | \$(870 )              | \$(2,022)   |
| Loans held for sale   | - 3,134           | (422 )                | 164         |
| Total assets:         | \$- \$8,850       | \$(1,292)             | \$(1,858)   |

#### *Small Business Loans*

Small business loans represent the secured subordinated debt extended by HCC LLC to small to mid-sized companies. At inception, the loans were carried at the principal amount outstanding net of deferred fees, deferred costs and the allowance for loan losses. Changes to adopt investment company accounting were retrospectively applied and as of September 30, 2012, HCC LLC reported all investments, including debt investments, at market value or, in the absence of a readily available market value, at fair value, with unrealized gains and losses recorded in Gain on sale, payoff and mark-to-market on the Consolidated Statements of Operations. The Company recorded unrealized gains of \$0.4 million relating to the fair value adjustment of small business loans in 2012. The Company recorded unrealized gains of \$0.1 million relating to the fair value adjustment of small business loans in 2013, prior to the deconsolidation of HCC LLC on May 2, 2013.

In connection with the HCC initial public offering on May 2, 2013, the Company ceased consolidating HCC LLC and began recognizing its investment, including common stock and warrants of HCC, using the fair value option. The Company's investments in HCC common stock and warrants are included in other investments. The deconsolidation of HCC LLC resulted in a net loss of \$35 thousand. The Company recorded unrealized gains of \$0.1 million in the year ended December 31, 2013 related to its investments in HCC LLC. The Company recognized the initial loss on deconsolidation and subsequent market adjustments to its investments in principal transactions. Dividends received during the year ended December 31, 2013 on HCC stock of \$0.5 million were recorded in net dividend income on the Consolidated Statements of Operations.

#### *Loans Held for Investment*

At December 31, 2013 and 2012, loans held for investment included two loans and one loan, respectively. Given the small size of this loan portfolio segment, the Company reviews credit quality of the loans within this portfolio segment on a loan by loan basis mainly focusing on the borrower's financial position and results of operations as well as the current and expected future cash flows on the loan.

Effective July 1, 2013, the Company agreed to lend a health sciences fund investment advising company up to \$2.0 million, at an interest rate of 10% per year. The outstanding principal balance and all accrued and unpaid interest is due and payable on July 1, 2018. As of December 31, 2013, the Company's loan outstanding to this entity was \$0.8 million.

The Company determined the fair value of loans held for investment to be \$0.7 million and \$0.2 million as of December 31, 2013 and 2012, respectively, using anticipated cash flows, discounted at an appropriate market credit adjusted interest rate.

#### *Investments at Cost*

On February 11, 2010, the Company made a \$1.5 million investment in Class D Preferred Units of Sanctuary Wealth Services LLC (“Sanctuary”), which provides a turnkey platform that allows independent wealth advisors. During the fourth quarter of 2010, the Company determined that its investment in Sanctuary was fully impaired and recorded an impairment loss of \$1.5 million, which was included in Principal Transactions on the Consolidated Statements of Operations.

On April 3, 2012, the Company purchased a \$2.3 million receivable for \$1.4 million from Sanctuary. The \$1.4 million was comprised of \$0.5 million in cash consideration and \$0.9 million in connection with the partial redemption of the \$1.5 million investment in Sanctuary. The Company recognized the \$0.9 million as a gain in Principal Transactions, and the \$2.3 million receivable in Other Assets. The carrying value of the long-term receivable was \$1.2 million as of December 31, 2013. The Company determined the fair value of the long-term receivable to be \$1.4 million as of December 31, 2013, using anticipated cash flows, discounted at an appropriate market credit adjusted interest rate. Significant increases in the market credit adjusted interest rate in isolation would result in decreases to the fair value measurement.

*Derivative Financial Instruments*

The Company entered into a forward purchase contract to secure the acquisition of shares of a privately-held company. The contract and subsequent amendment incorporates downside protection for up to two years, for a cost basis of \$5.0 million. In January 2012, the Company exchanged \$5.0 million for physical custody of the shares. For two years beginning December 1, 2012, the Company could, at its discretion, become the beneficial and record holder of the shares. If the Company has not yet exercised its option at December 1, 2014, the shares will be assigned automatically to the Company. This contract is recorded in Other Investments in the Consolidated Statements of Financial Condition at fair value. The Company records changes in the fair value of this forward contract as unrealized gain or loss in Principal Transactions. For the years ended December 31, 2013 and 2012, the Company recorded \$1.4 million and \$0.4 million unrealized gain. Once the shares are in the Company's name, the shares will be accounted for as equity securities, remaining in Other Investments in the Consolidated Statements of Financial Condition.

**5. Loans Collateralizing Asset-backed Securities Issued and Loans Held for Sale**

Loans collateralizing asset-backed securities issued and loans held for sale are commercial loans securitized and owned by the Company's CLOs. The loans consist of those loans within the CLO securitization structure at the acquisition date of Cratos and loans purchased by the CLOs subsequent to the Cratos acquisition date. As of December 31, 2013, CLO III was not yet funded, and therefore, the loan in this entity was not collateralizing asset-backed securities issued. However, given the intent of the CLO III structure, this loan was included in loans collateralizing asset-backed securities line item. The following table presents the components of loans collateralizing asset-backed securities issued and loans held for sale as of December 31, 2013 and 2012:

| <i>(In thousands)</i> | <b>As of December 31,</b> |              |                       |              |
|-----------------------|---------------------------|--------------|-----------------------|--------------|
|                       | <b>2013</b>               |              | <b>2012</b>           |              |
|                       | <b>Loans</b>              | <b>Loans</b> | <b>Loans</b>          | <b>Loans</b> |
|                       | <b>Collateralized</b>     | <b>held</b>  | <b>Collateralized</b> | <b>held</b>  |
|                       | <b>Asset-backed</b>       | <b>for</b>   | <b>Asset-backed</b>   | <b>for</b>   |

|                           | Securities | Sale | Securities | Sale    |
|---------------------------|------------|------|------------|---------|
| Outstanding principals    | \$735,891  | \$ - | \$414,000  | \$4,686 |
| Allowance for loan losses | (3,871 )   | -    | (3,127 )   | -       |
| Liquidity discount        | (1,168 )   | -    | (3,052 )   | (1,279) |
| Deferred loan fees, net   | (3,582 )   | -    | (6,818 )   | (156 )  |
| Valuation allowance       | N/A        | -    | N/A        | (117 )  |
| Total loans, net          | \$727,270  | \$ - | \$401,003  | \$3,134 |

Loans recorded upon the acquisition of Cratos at fair value reflect a liquidity discount and a credit discount. The table below summarizes the activity in the loan principal, allowance for loan losses, liquidity discount, deferred loan fees, and the carrying value for the impaired and non-impaired loans as of and for the year ended December 31, 2013:

(In thousands)

**Year Ended December 31, 2013**

|                                       | Principal | Allowance<br>for<br>Loan<br>Losses | Liquidity<br>Discount | Credit<br>Discount | Deferred<br>Loan<br>Fees | Carrying<br>Value,<br>Net |
|---------------------------------------|-----------|------------------------------------|-----------------------|--------------------|--------------------------|---------------------------|
| <b>Impaired Loans</b>                 |           |                                    |                       |                    |                          |                           |
| Balance at beginning of period        | \$3,517   | \$ (1,022 )                        | \$ (720 )             | \$ -               | \$ (16 )                 | \$1,759                   |
| Accretion of discount                 | (11 )     | -                                  | -                     | -                  | 2                        | (9 )                      |
| Provision for loan losses             | -         | (870 )                             | -                     | -                  | -                        | (870 )                    |
| Sales and payoff                      | (3,506 )  | 1,892                              | 720                   | -                  | 14                       | (880 )                    |
| Balance at end of period              | \$-       | \$ -                               | \$ -                  | \$ -               | \$ -                     | \$-                       |
| <b>Non-impaired Loans</b>             |           |                                    |                       |                    |                          |                           |
| Balance at beginning of period        | \$410,483 | \$ (2,105 )                        | \$ (2,332 )           | \$ -               | \$ (6,802 )              | \$399,244                 |
| Purchases                             | 591,365   | -                                  | -                     | -                  | (433 )                   | 590,932                   |
| Repayments                            | (49,324 ) | -                                  | -                     | -                  | -                        | (49,324 )                 |
| Accretion of discount                 | -         | -                                  | 692                   | -                  | 1,793                    | 2,485                     |
| Provision for loan losses             | -         | (1,766 )                           | -                     | -                  | -                        | (1,766 )                  |
| Sales and payoff                      | (211,492) | -                                  | 85                    | -                  | 1,860                    | (209,547)                 |
| Transfers to/from loans held for sale | (5,141 )  | -                                  | 387                   | -                  | -                        | (4,754 )                  |
| Balance at end of period              | \$735,891 | \$ (3,871 )                        | \$ (1,168 )           | \$ -               | \$ (3,582 )              | \$727,270                 |



The table below summarizes the activity in the loan principal, allowance for loan losses, liquidity discount, credit discount, deferred loan fees, and the carrying value for the impaired non-impaired loans as of and for the year ended December 31, 2012:

|   | Year Ended December 31, 2012 |                                 |                       |                    |                          |                           |
|---|------------------------------|---------------------------------|-----------------------|--------------------|--------------------------|---------------------------|
|   | Principal                    | Allowance<br>for Loan<br>Losses | Liquidity<br>Discount | Credit<br>Discount | Deferred<br>Loan<br>Fees | Carrying<br>Value,<br>Net |
| <b>Impaired Loans</b>                     |                              |                                 |                       |                    |                          |                           |
| Balance at beginning of period            | \$10,538                     | \$ (2,277 )                     | \$ (5,924 )           | \$ (1,335 )        | \$ (54 )                 | \$948                     |
| Purchases                                 | 5                            | -                               | -                     | -                  | -                        | 5                         |
| Repayments                                | (179 )                       | -                               | -                     | -                  | -                        | (179 )                    |
| Accretion of discount                     | -                            | -                               | 172                   | -                  | 13                       | 185                       |
| Provision for loan losses                 | -                            | (2,022 )                        | -                     | -                  | -                        | (2,022 )                  |
| Sales and payoff                          | (3,197 )                     | 1,525                           | 735                   | 937                | -                        | -                         |
| Write-off / restructuring                 | (7,167 )                     | 1,752                           | 5,017                 | 398                | 41                       | 41                        |
| Transfers to/from non-impaired loans, net | 3,517                        | -                               | (720 )                | -                  | (16 )                    | 2,781                     |
| Balance at end of period                  | \$3,517                      | \$ (1,022 )                     | \$ (720 )             | \$ -               | \$ (16 )                 | \$1,759                   |
| <b>Non-impaired Loans</b>                 |                              |                                 |                       |                    |                          |                           |
| Balance at beginning of period            | \$426,416                    | \$ (1,922 )                     | \$ (8,535 )           | \$ -               | \$ (6,137 )              | \$409,822                 |
| Purchases                                 | 207,964                      | -                               | -                     | -                  | (5,342 )                 | 202,622                   |
| Repayments                                | (39,204 )                    | -                               | -                     | -                  | -                        | (39,204 )                 |
| Accretion of discount                     | -                            | -                               | 4,519                 | -                  | 2,130                    | 6,649                     |
| Provision for loan losses                 | -                            | (183 )                          | -                     | -                  | -                        | (183 )                    |
| Sales and payoff                          | (181,176)                    | -                               | 964                   | -                  | 2,531                    | (177,681)                 |
| Transfers to/from impaired loans, net     | (3,517 )                     | -                               | 720                   | -                  | 16                       | (2,781 )                  |
| Balance at end of period                  | \$410,483                    | \$ (2,105 )                     | \$ (2,332 )           | \$ -               | \$ (6,802 )              | \$399,244                 |

#### Allowance for Loan Losses

The Company recorded specific reserves of \$0.9 million, \$2.0 million and \$1.7 million on impaired loans and general reserves of \$1.8 million, \$0.2 million and \$0.5 million on non-impaired loans during the years ended December 31, 2013, 2012 and 2011, respectively. A summary of the activity in the allowance for loan losses for the years ended December 31, 2013, 2012 and 2011 is as follows:

|                                | Year Ended December 31, |           |           |
|--------------------------------|-------------------------|-----------|-----------|
|                                | 2013                    | 2012      | 2011      |
| Balance at beginning of period | \$(3,127)               | \$(4,199) | \$(1,992) |

## Provision for loan losses:

|  |           |           |           |
|--|-----------|-----------|-----------|
| Specific reserve                                     | (870 )    | (2,022)   | (1,695)   |
| General reserve                                      | (1,766)   | (183 )    | (512 )    |
| Reversal due to sale, payoff or restructure of loans | 1,892     | 3,277     | -         |
| Balance at end of period                             | \$(3,871) | \$(3,127) | \$(4,199) |

*Impaired Loans*

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. As of December 31, 2013, the Company held no impaired loans. As of December 31, 2012, \$2.8 million of recorded investment amount of loans collateralizing asset-backed securities issued were individually evaluated for impairment. The remaining \$731.1 million and \$401.3 million of recorded investment amount of loans collateralizing asset-backed securities issued were collectively evaluated for impairment, as of December 31, 2013 and December 31, 2012 respectively.

The table below presents certain information pertaining to the impaired loans as of and for the years ended December 31, 2013 and 2012:

| <i>(In thousands)</i>                             | <b>Recorded Investment</b> | <b>Unpaid Principal Balance</b> | <b>Related Allowance</b> | <b>Average Recorded Investment</b> | <b>Interest Income Recognized</b> |
|---|----------------------------|---------------------------------|--------------------------|------------------------------------|-----------------------------------|
| <b>2013</b>                                       |                            |                                 |                          |                                    |                                   |
| Impaired loans with an allowance recorded         | \$ -                       | \$ -                            | \$ -                     | \$ 2,741                           | \$ -                              |
| Impaired loans with no related allowance recorded | -                          | -                               | -                        | -                                  | -                                 |
|   | \$ -                       | \$ -                            | \$ -                     | \$ 2,741                           | \$ -                              |
| <b>2012</b>                                       |                            |                                 |                          |                                    |                                   |
| Impaired loans with an allowance recorded         | \$ 2,781                   | \$ 3,517                        | \$ 1,022                 | \$ 4,743                           | \$ 162                            |
| Impaired loans with no related allowance recorded | -                          | -                               | -                        | -                                  | -                                 |
|   | \$ 2,781                   | \$ 3,517                        | \$ 1,022                 | \$ 4,743                           | \$ 162                            |

*Non-Accrual, Past Due Loans and Restructured Loans*

As of December 31, 2013 and 2012, the Company classified all its loans as Cash Flow loans, as their funding decisions were all driven by the revenues of the borrower. At December 31, 2013, no loans were on non-accrual status. At December 31, 2012, one loan with an aggregate principal amount of \$3.5 million and recorded investment amount of \$2.8 million was on non-accrual status. The Company recorded no interest income, other than the accretion of liquidity discounts, for the impaired loans with a weighted average loan balance of \$2.7 million that were on non-accrual status during the year ended December 31, 2013. The Company recognized \$0.2 million of interest income for three non-accrual status loans with an average recorded loan balance of \$4.7 million that were on non-accrual status during the year ended December 31, 2012.

Loans are considered past due if the required principal and interest payments have not been received as of the date such payments were due. At December 31, 2012, one non-accrual loan in the amount of \$2.8 million was over 90 days past due. No other loans were past due at December 31, 2013 or December 31, 2012.

At December 31, 2012, the Company's impaired loans included two loans, with an aggregate recorded investment balance of \$2.0 million, whose terms were modified in a troubled debt restructuring ("TDR"). Concessions for these TDRs included a below market interest rate and a reduction in the loan principal balance. Subsequently, one loan was paid off, and the other loan was sold. At December 31, 2013, the Company held no loans whose terms were modified in a TDR.

*Credit Quality of Loans*

The Company's management, at least on a quarterly basis, reviews each loan and evaluates the credit quality of the loan. The review primarily includes the following credit quality indicators with regard to each loan: 1) Moody's rating, 2) current internal rating and 3) performance. The tables below present, by credit quality indicator, the Company's recorded investment in loans collateralizing asset-backed securities issued at December 31, 2013 and 2012:

| <i>(In thousands)</i> | <b>Senior Secured Bonds/ Notes</b> | <b>Cash Flow (CF)</b> | <b>Held for Sale -</b> |
|-----------------------|------------------------------------|-----------------------|------------------------|
|                       | -                                  |                       | <b>Cash Flow (CF)</b>  |
|                       | <b>Cash Flow December 31,</b>      | <b>December 31,</b>   | <b>December 31,</b>    |

|                         | 2013           | 2012        | 2013             | 2012             | 2013       | 2012           |
|-------------------------|----------------|-------------|------------------|------------------|------------|----------------|
| <b>Moody's rating:</b>  |                |             |                  |                  |            |                |
| Baa1 - Baa3             | \$-            | \$ -        | \$16,057         | \$5,883          | \$-        | \$-            |
| Ba1 - Ba3               | -              | -           | 215,281          | 129,796          | -          | -              |
| B1 - B3                 | 3,114          | -           | 482,579          | 263,390          | -          | -              |
| Caa1 - Caa3             | -              | -           | 13,729           | 5,061            | -          | 3,134          |
| Ca                      | -              | -           | 381              | -                | -          | -              |
| <b>Total:</b>           | <b>\$3,114</b> | <b>\$ -</b> | <b>\$728,027</b> | <b>\$404,130</b> | <b>\$-</b> | <b>\$3,134</b> |
| <b>Internal rating:</b> |                |             |                  |                  |            |                |
| 2                       | \$3,114        | \$ -        | \$700,168        | \$392,208        | \$-        | \$-            |
| 3                       | -              | -           | 27,859           | 11,922           | -          | -              |
| 4                       | (1) -          | -           | -                | -                | -          | 3,134          |
| <b>Total:</b>           | <b>\$3,114</b> | <b>\$ -</b> | <b>\$728,027</b> | <b>\$404,130</b> | <b>\$-</b> | <b>\$3,134</b> |
| <b>Performance:</b>     |                |             |                  |                  |            |                |
| Performing              | \$3,114        | \$ -        | \$728,027        | \$401,349        | \$-        | \$3,134        |
| Non-performing          | -              | -           | -                | 2,781            | -          | -              |
| <b>Total:</b>           | <b>\$3,114</b> | <b>\$ -</b> | <b>\$728,027</b> | <b>\$404,130</b> | <b>\$-</b> | <b>\$3,134</b> |

(1) Loans with an internal rating of 4 or below are reviewed individually to identify loans to be designated for non-accrual status.

The Company determined the fair value of loans collateralizing asset-backed securities to be \$737.3 million and \$412.0 million as of December 31, 2013 and 2012, respectively; primarily using the average market bid and ask quotation obtained from a loan pricing service. Such loans are identified as Level 2 assets. The valuation analysis incorporates comparable loans traded in the marketplace, the obligor's industry, future business prospects, capital structure, and expected credit losses. Significant declines in the performance of the obligor would result in decreases to the fair value measurement.

The fair value of the loan held for sale was determined to be zero and \$3.1 million as of December 31, 2013 and 2012, using similar methodology. Based on the fair value methodology, the Company has identified the loan held for sale as a Level 2 asset.

## 6. Fixed Assets

At December 31, 2013 and 2012, fixed assets consisted of the following:

| <i>(In thousands)</i>          | <b>As of December</b> |             |
|--------------------------------|-----------------------|-------------|
|                                | <b>31,</b>            |             |
|                                | <b>2013</b>           | <b>2012</b> |
| Furniture and fixtures         | \$2,082               | \$2,053     |
| Computer and office equipment  | 4,935                 | 4,757       |
| Leasehold improvements         | 4,345                 | 4,205       |
| Software                       | 580                   | 576         |
| Less: accumulated depreciation | (9,850)               | (8,928)     |
| Total fixed assets, net        | \$2,092               | \$2,663     |

Depreciation expense for the years ended December 31, 2013, 2012 and 2011 were \$0.9 million, \$0.9 million, and \$0.7 million, respectively.

## 7. Debt

### *Bond Payable*

In January 2013, the Company completed an underwritten public offering of \$46.0 million aggregate principal amount of 8.00% senior notes (the “2013 Senior Notes”). The 2013 Senior Notes will mature January 15, 2023, and may be redeemed in whole or in part at any time or from time to time at the Company’s option on or after January 15, 2016, on not less than 30 or more than 60 days’ prior notice mailed to the holders of the 2013 Senior Notes. The 2013 Senior Notes will be redeemable at a redemption price equal to the principal amount redeemed plus accrued and unpaid interest. The 2013 Senior Notes bear interest at a rate of 8.00% per year, payable quarterly on January 15, April 15, July 15 and October 15 of each year, beginning on April 15, 2013.

The 2013 Senior Notes were issued pursuant to an indenture with U.S. Bank National Association, as trustee. The indenture contains a minimum liquidity covenant that obligates the Company to maintain liquidity of at least an amount equal to the lesser of (i) the aggregate amount due on the next eight scheduled quarterly interest payments on the 2013 Senior Notes, or (ii) the aggregate amount due on all remaining scheduled quarterly interest payments on the 2013 Senior Notes until the maturity of the 2013 Senior Notes. The indenture also contains customary event of default and cure provisions. If an uncured default occurs and is continuing, the Trustee or the holders of at least 25% in

principal amount of the 2013 Senior Notes may declare the 2013 Senior Notes immediately due and payable.

The notes will be our general unsecured senior obligations, will rank equally with all of our existing and future senior unsecured indebtedness and will be senior to any other indebtedness expressly made subordinate to the notes. The notes will be effectively subordinated to all of our existing and future secured indebtedness (to the extent of the value of the assets securing such indebtedness) and structurally subordinated to all existing and future liabilities of our subsidiaries, including trade payables.

The Company incurred \$1.7 million of debt issuance costs, which were capitalized and included in Other Assets. These issuance costs are amortized over the estimated life of the bond. As of December 31, 2013, the Company held \$1.6 million of unamortized debt issuance costs.

#### *Note Payable and Line of Credit*

The Company's indebtedness includes a term loan related to the Company's Credit Agreement with City National Bank (the "Lender"), as defined below, and borrowing on a revolving line of credit related to HGC II.

The Company's Credit Agreement, dated as of August 3, 2006, was entered by and between JMP Group LLC and the Lender, and was subsequently amended by Amendment Number One to Credit Agreement, dated as of December 17, 2007, Amendment Number Two to Credit Agreement, dated as of March 27, 2008, Amendment Number Three to Credit Agreement (the "Third Amendment"), dated as of December 31, 2008, Amendment Number Four to Credit Agreement and Waiver, dated as of January 28, 2010, Amendment Number Five to Credit Agreement (the "Fifth Amendment"), dated as of April 8, 2011, Amendment Number Six to Credit Agreement (the "Sixth Amendment"), dated as of August 24, 2011, and the Amended and Restated Credit Agreement ("Amended and Restated Credit Agreement"), dated as of October 11, 2012 (collectively, the "Credit Agreement"). The terms of the Credit Agreement as of December 31, 2012 and December 31, 2013 are as follows.

The Third Amendment converted outstanding revolving loans of \$8.7 million into a term loan as of December 31, 2008. The term loan was repaid in equal quarterly payments of \$0.4 million, which commenced on March 31, 2009 and continued through December 31, 2013 and bore interest at LIBOR plus 2.25%. The outstanding balance on this term loan was paid off in full as of December 31, 2013.

The Third Amendment and the Amended and Restated Credit Agreement converted an outstanding revolving loan of \$21.0 million into a term loan that fully matured on December 31, 2013. This term loan was repaid in equal quarterly payments of \$1.8 million, which commenced on April 1, 2011 and continued through December 31, 2013, and bore interest at LIBOR plus 2.25%. The outstanding balance on this term loan was paid off in full as of December 31, 2013.

Under the Fifth Amendment, JMP Securities entered into a \$20.0 million revolving line of credit with the Lender to be used for regulatory capital purposes during its securities underwriting activities. The unused portion of the line bears interest at the rate of 0.25% per annum, paid monthly. Draws on the revolving line of credit bear interest at the rate of prime and are available through May 6, 2014, on which date, any existing outstanding amount will convert to a loan maturing on May 6, 2015. On October 11, 2012, the Amended and Restated Credit Agreement reduced the revolving subordinated line of credit from \$20.0 million to \$10.0 million. On May 7, 2013, the subordinated line of credit was increased back to \$20.0 million. On October 11, 2013, the subordinated line of credit was reduced to \$15.0 million. There was no borrowing on this line of credit as of December 31, 2013 or December 31, 2012.

Pursuant to the Amended and Restated Credit Agreement, the Lender agreed to extend a \$15.0 million term loan. On April 25, 2013, JMP Group drew \$15.0 million on the term loan. This term loan will be repaid in quarterly installments of \$1.2 million beginning March 31, 2014 and continuing through September 30, 2016, with a final payment of approximately \$1.3 million on December 31, 2016. The outstanding balance on this term loan was \$15.0 million as of December 31, 2013.

The Credit Agreement provides a line of credit of up to \$30.0 million to the extent the aggregate outstanding balance of all facilities do not exceed \$58.5 million. The unused portion of the line bears interest at the rate of 0.25% per annum, paid quarterly. The line of credit will remain available through April 30, 2014. On such date, any outstanding amounts convert to a term loan. The term loan will be repaid in quarterly installments of 3.75% of funded debt for the first two years, 5.00% of funded debt for the next two years, and the remainder due at maturity on August 24, 2017. The Company anticipated that the proceeds for this line of credit would be used to fund certain commitments to HCC LLC, to repurchase Company stock and other permitted investments, and for other general working capital purposes. The Company's outstanding balance on this line of credit was zero and \$28.2 million as of December 31, 2013 and December 31, 2012, respectively.

On November 22, 2013, HGC II entered into a line of credit of \$3.0 million with CNB. The unused portion of the line bears interest at the rate of prime plus 0.5% per annum, paid quarterly. The line of credit will be available through December 1, 2015 or fifteen days prior to the expiration of the Commitment Period of HGC II unless renewed. The proceeds for this line of credit will be used to purchase investments, prior to capital calls from HGC II investors. The Company's outstanding balance on this line of credit was \$2.9 million as of December 31, 2013.

The term loans had an aggregate outstanding principal amount of \$15.0 million and \$10.5 million at December 31, 2013 and December 31, 2012, respectively. The following table shows the repayment schedules for the principal portion of the term loans at December 31, 2013:

| <i>(In thousands)</i> | <b>December<br/>31, 2013</b> |
|-----------------------|------------------------------|
| 2014                  | 4,980                        |
| 2015                  | 4,980                        |
| 2016                  | 5,040                        |
|                       | \$ 15,000                    |

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 Credit Agreement, which would permit the bank to terminate our note and require the immediate repayment of any outstanding principal and interest. At December 31, 2013, the Company was in compliance with the loan covenants. The term loans are collateralized by a pledge of the Company's assets, including its interests in each of JMP Securities and HCS.



On May 29, 2010 the Company entered into an interest rate cap with the Lender to effectively lock in or fix the interest rate on its revolving line of credit and term loan from July 1, 2010 through maturity. The interest rate cap will allow the Company to receive payments from the counterparty in the event that LIBOR plus 2.25% exceeds 3.75%, limiting the interest rate on the outstanding balance of the term loan to such rate. The cap had an initial notional principal amount of \$27.1 million, indexed to LIBOR and amortizes in accordance with the amortization of the revolving line of credit and term loan. The notional principal amount of the cap was zero at December 31, 2013. For the years ended December 31, 2013 and 2012, \$55 thousand and \$47 thousand, respectively, were reclassified from accumulated other comprehensive income into interest expense as amortization of the interest cap. On December 31, 2013, the interest rate cap expired.

## **8. Asset-backed Securities Issued**

### *CLO I*

On May 17, 2007, CLO I 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 CLO I. The Notes were issued in six separate classes as set forth in the table below. The Company owns approximately 94.0% of the unsecured subordinated notes and \$13.8 million of Class C, D and E notes (\$2.0 million of Class C, \$4.1 million of Class D and \$7.7 million of Class 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 December 31, 2013 and 2012.

| <i>(In millions)</i>   | <b>As of December 31, 2013</b>         |  |  |  | <b>Ratings<br/>(Moody's<br/>/S&amp;P) (1)</b> |
|--|--|--|--|--|---|
|  | <b>Notes<br/>Originally<br/>Issued</b> | <b>Outstanding<br/>Principal<br/>Balance</b> | <b>Net<br/>Outstanding<br/>Balance</b> | <b>Interest Rate<br/>Spread to LIBOR</b> |   |
| Class A Senior Secured Floating Rate Revolving Notes due 2021  | \$ 326.0                               | \$ 289.0                                     | \$ 289.0                               | 0.26% - 0.29%                            | Aaa/AAA                                       |
| Class B Senior Secured Floating Rate Notes due 2021            | 30.0                                   | 30.0   | 30.0                                   | 0.50%                                    | Aaa/AAA                                       |
| Class C Senior Secured Deferrable Floating Rate Notes due 2021 | 35.0                                   | 35.0   | 35.0                                   | 1.10%                                    | Aaa/AA+                                       |
| Class D Secured Deferrable Floating Rate Notes due 2021        | 34.0                                   | 34.0   | 34.0                                   | 2.40%                                    | A1/A-   |
| Class E Secured Deferrable Floating Rate Notes due 2021        | 30.0                                   | 30.0   | 30.0                                   | 5.00%                                    | Ba1/BB  |
| Total secured notes sold to investors                          | \$ 455.0                               | \$ 418.0                                     | \$ 418.0                               |  |   |
| Unsecured subordinated notes due 2021                          | 45.0                                   | 45.0   | 45.0                                   |  |   |
| Total notes for the CLO I offering                             | \$ 500.0                               | \$ 463.0                                     | \$ 463.0                               |  |   |
| Consolidation elimination                                      | N/A                                    | (58.7 )                                      | (58.7 )                                |  |   |
| Total asset-backed securities issued                           | N/A                                    | \$ 404.3                                     | \$ 404.3                               |  |   |

(1) These ratings are unaudited and were the current ratings as of December 31, 2013 and are subject to change from time to time.

| <i>(In millions)</i>   | <b>As of December 31, 2012</b>         |  |  |  | <b>Ratings<br/>(Moody's<br/>/S&amp;P) (1)</b> |
|--|--|--|--|--|---|
|  | <b>Notes<br/>Originally<br/>Issued</b> | <b>Outstanding<br/>Principal<br/>Balance</b> | <b>Net<br/>Outstanding<br/>Balance</b> | <b>Interest Rate<br/>Spread to LIBOR</b> |   |
| Class A Senior Secured Floating Rate Revolving Notes due 2021  | \$ 326.0                               | \$ 315.8                                     | \$ 310.3                               | 0.26% - 0.29%                            | Aaa/AAA                                       |
| Class B Senior Secured Floating Rate Notes due 2021            | 30.0                                   | 30.0   | 28.6                                   | 0.50%                                    | Aaa/AAA                                       |
| Class C Senior Secured Deferrable Floating Rate Notes due 2021 | 35.0                                   | 35.0   | 31.7                                   | 1.10%                                    | Aa3/AA+                                       |
| Class D Secured Deferrable Floating Rate Notes due 2021        | 34.0                                   | 34.0   | 30.7                                   | 2.40%                                    | A3/A-   |
| Class E Secured Deferrable Floating Rate Notes due 2021        | 30.0                                   | 30.0   | 26.8                                   | 5.00%                                    | Ba2/BB  |

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|                                       |          |          |          |
|---------------------------------------|----------|----------|----------|
| Total secured notes sold to investors | \$ 455.0 | \$ 444.8 | \$ 428.1 |
| Unsecured subordinated notes due 2021 | 45.0     | 45.0     | 5.1      |
| Total notes for the CLO I offering    | \$ 500.0 | \$ 489.8 | \$ 433.2 |
| Consolidation elimination             | N/A      | (58.8 )  | (17.7 )  |
| Total asset-backed securities issued  | N/A      | \$ 431.0 | \$ 415.5 |

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These ratings are unaudited and were the current ratings as of (1) December 31, 2012 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 under the applicable payment priority provisions. To the extent proceeds are not so available, interest on the Class C, Class D and Class E notes will be deferred. As of December 31, 2013 and 2012, all interest on the secured notes was current. The CLO 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. As of December 31, 2013 and 2012, all of the Class A-1 notes were drawn. The secured notes are secured by the CLO 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 loan portfolio to a number of collateral quality, portfolio profile, interest coverage and overcollateralization tests.

The reinvestment period for CLO I ended in May 2013, and all scheduled principal payments from the borrowers are applied to paying down the most senior (AAA) CLO notes. The Company is still permitted to reinvest unscheduled principal payments, which includes most loan payoffs. However, in order to reinvest these proceeds, CLO I is required to maintain or improve its weighted average life covenant, the replacement collateral is required to have the same or better Moody's and S&P ratings as the loan that prepaid, and the maturity date cannot be later than that of the loan that

prepaid. These restrictions make reinvestment increasingly difficult as time lapses, which will result in the CLO being paid down more rapidly. CLO I paid down \$26.7 million in the year ended December 31, 2013.

The Notes recorded upon the closing of Cratos in April 2009 reflect an issuance discount. The activity in the note principal and liquidity discount for the years ended December 31, 2013 and 2012 comprised the following:

| <i>(In thousands)</i>          | Year Ended December 31, 2013 |                    |           | Year Ended December 31, 2012 |                    |           |
|--------------------------------|------------------------------|--------------------|-----------|------------------------------|--------------------|-----------|
|                                | Principal                    | Liquidity Discount | Net       | Principal                    | Liquidity Discount | Net       |
| Balance at beginning of period | \$431,003                    | \$(15,548 )        | \$415,455 | \$431,003                    | \$(49,447 )        | \$381,556 |
| Repayments                     | (26,723 )                    | -                  | (26,723 ) | -                            | -                  | -         |
| Amortization of discount       | -                            | 15,548             | 15,548    | -                            | 33,899             | 33,899    |
| Balance at end of period       | \$404,280                    | \$-                | \$404,280 | \$431,003                    | \$(15,548 )        | \$415,455 |

### CLO II

On April 30, 2013, CLO II completed the issuance of \$343.8 million aggregate principal amount of notes (the “Secured Notes”). The Secured Notes offered in this proposed transaction were issued in multiple tranches and are rated by Standard & Poor’s Ratings Services and, in respect of certain tranches, Moody’s Investors Service, Inc. The Secured Notes will be repaid from the cash flows generated by the loan portfolio owned by CLO II. The Company owns approximately 72.8% of the unsecured subordinated notes. These unsecured subordinated notes are eliminated upon consolidation of JMP Credit, and therefore, are not reflected on the Company’s consolidated statement of financial condition at December 31, 2013.

| <i>(In millions)</i>                                 | As of December 31, 2013 |                               |                   |                         |                               |                       |
|--|-------------------------|-------------------------------|-------------------|-------------------------|-------------------------------|-----------------------|
|  | Notes Issued            | Outstanding Principal Balance | Issuance Discount | Net Outstanding Balance | Interest Rate Spread to LIBOR | Ratings (Moody's) (1) |
| Class X Senior Secured Floating Rate Notes due 2016  | \$3.8                   | \$ 3.8                        | \$ -              | \$ 3.8                  | 1.00                          | % AAA                 |
| Class A Senior Secured Floating Rate Notes due 2023  | 217.6                   | 217.6                         | (0.8 )            | 216.8                   | 1.18                          | % AAA                 |
| Class B Senior Deferred Floating Rate Notes due 2023 | 34.0                    | 34.0                          | (0.3 )            | 33.7                    | 1.75                          | % AA                  |
| Class C Senior Deferred Floating Rate Notes due 2023 | 17.0                    | 17.0                          | (0.6 )            | 16.4                    | 2.75                          | % A                   |
| Class D Senior Deferred Floating Rate Notes due 2023 | 18.7                    | 18.7                          | (1.6 )            | 17.1                    | 3.85                          | % BBB                 |
| Class E Senior Deferred Floating Rate Notes due 2023 | 18.7                    | 18.7                          | (2.5 )            | 16.2                    | 5.25                          | % BB                  |

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|  |         |          |           |          |         |
|--|---------|----------|-----------|----------|---------|
| Class F Senior Deferred Floating Rate Notes due 2023 | 10.2    | 10.2     | (2.1 )    | 8.1      | 5.75 %B |
| Total secured notes sold to investors                | \$320.0 | \$ 320.0 | \$ (7.9 ) | \$ 312.1 |         |
| Unsecured subordinated notes due 2023                | 23.8    | 23.8     | (0.3 )    | 23.5     |         |
| Total notes for the CLO II offering                  | \$343.8 | \$ 343.8 | \$ (8.2 ) | \$ 335.6 |         |
| Consolidation elimination                            | N/A     | (23.8 )  | 0.3       | (23.5 )  |         |
| Total CLO II asset-backed securities issued          | N/A     | \$ 320.0 | \$ (7.9 ) | \$ 312.1 |         |

These ratings are unaudited and were the current ratings as of (1) December 31, 2013 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 II loan portfolio and related collection and payment accounts pledged as security. Payment on the Class X notes rank equal, or pari-passu, in right of payment with payments on the Class A notes and payment on the Class X and Class A 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 commencing October 2013 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 under the applicable payment priority provisions. To the extent proceeds are not so available, interest on the Class C, Class D and Class E notes will be deferred. The secured notes are secured by the CLO II 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 II loan portfolio to a number of collateral quality, portfolio profile, interest coverage and overcollateralization tests.

The Notes recorded upon the issuance of CLO II in April 2013 at fair value reflect an issuance discount. The activity in the note principal and issuance discount for the year ended December 31, 2013 comprised the following:

(In thousands)

|  | Year Ended December 31, 2013 |                   |     |
|--|------------------------------|-------------------|-----|
|  | Principal                    | Issuance Discount | Net |

|                                |           |             |           |
|--------------------------------|-----------|-------------|-----------|
| Balance at beginning of period | \$-       | \$ -        | \$-       |
| CLO II issuance                | 320,000   | (8,437 )    | 311,563   |
| Amortization of discount       | -         | 580         | 580       |
| Balance at end of period       | \$320,000 | \$ (7,857 ) | \$312,143 |

*CLO III*

On December 11, 2013 CLO III closed on a \$100.0 million warehouse credit agreement with BNP Paribas. CLO III is a special purpose vehicle whose debt will be secured by a diversified portfolio of broadly syndicated leveraged loans. As of December 31, 2013, CLO III was not funded.

*Interest on Asset Backed Securities Issued*

Total interest expenses related to the asset-backed securities issued for the year ended December 31, 2013 and 2012 were \$25.6 million and \$39.1 million, respectively, which was comprised of a cash coupon of \$9.2 million and \$5.2 million and liquidity and issuance discount amortization of \$16.4 million and \$33.9 million, respectively. As of December 31, 2013 and 2012, accrued interest payable on the Notes were \$1.9 million and \$0.5 million, respectively.

*Fair Value of Asset Backed Securities Issued*

The Company determined the fair value of the secured notes of the asset-backed securities issued to be \$711.0 million and \$404.3 million as of December 31, 2013 and 2012, respectively, based upon pricing from published market research for equivalent-rated CLO notes. Based on the fair value methodology, the Company has identified the asset-backed securities issued as Level 2 liabilities.

**9. Stockholders' Equity**

*Common Stock*

The Company's board of directors declared a quarterly cash dividend of \$0.035 per share of common stock in March, May and July 2013, and \$0.040 per share of common stock in October 2013. Those dividends were paid in April, May, August and November 2013 for the fourth quarter of 2012, the first, second and third quarter of 2013, respectively.

*Stock Repurchase Program*

The Company's board of directors authorized the repurchase of 1.0 million shares during the eighteen months subsequent to November 1, 2011, and the repurchase of an additional 0.5 million shares during the fourteen months subsequent to October 30, 2012. On March 5, 2013, the Company's board of directors authorized the repurchase of 1.3 million shares, and extended the authorization of the repurchase of all previously authorized shares for repurchases through December 31, 2014.



During the years ended December 31, 2013 and 2012, the Company repurchased 890,376 and 858,137 shares, respectively, of the Company's common stock at an average price of \$6.50 per share and \$6.58 per share, respectively, for an aggregate purchase price of \$5.8 million and \$5.7 million, respectively. Of the total shares repurchased during the years ended December 31, 2013 and 2012, 40,835 shares and 603,328 shares, respectively, were deemed to have been repurchased in connection with employee stock plans, whereby the Company's shares were issued on a net basis to employees for the payment of applicable statutory withholding taxes and therefore such withheld shares are deemed to be purchased by the Company. 356,728 of the shares repurchased in 2013 were repurchased from certain JMPCA employees at a discount to market price in conjunction with their use of said proceeds as a long term capital commitment to CLO II. 135,680 of the shares repurchased during the year ended December 31, 2013 were repurchased from an employee. The remaining shares were purchased on the open market.

As of December 31, 2013, 1,112,908 shares remain available to be repurchased under the repurchase program.

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

## **10. 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. The board reauthorized this plan and it was approved by our stockholders on June 6, 2011. JMP Group Inc. authorized the issuance of 4,000,000 shares of its common stock under this 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.

*Stock Options*

The following table summarizes the stock option activity for the years ended December 31, 2013, 2012 and 2011:

|                                      | Year Ended December 31,<br>2013 |  | 2012                           |  | 2011                           |  |
|--------------------------------------|---------------------------------|--|--------------------------------|--|--------------------------------|--|
|                                      | Shares<br>Subject<br>to Option  | Weighted<br>Average<br>Exercise<br>Price | Shares<br>Subject<br>to Option | Weighted<br>Average<br>Exercise<br>Price | Shares<br>Subject<br>to Option | Weighted<br>Average<br>Exercise<br>Price |
| Balance, beginning of year           | 1,608,890                       | \$ 11.12                                 | 1,704,665                      | \$ 11.20                                 | 1,800,565                      | \$ 11.23                                 |
| Granted                              | 1,600,000                       | 6.23                                     | -                              | -  | -                              | -  |
| Forfeited                            | (50,000 )                       | 6.24                                     | -                              | -  | -                              | -  |
| Expired                              | (788,600 )                      | 12.29                                    | (95,775 )                      | 12.43                                    | (95,900 )                      | 11.82                                    |
| Balance, end of period               | 2,370,290                       | \$ 7.54                                  | 1,608,890                      | \$ 11.12                                 | 1,704,665                      | \$ 11.20                                 |
| Options exercisable at end of period | 820,290                         | \$ 10.00                                 | 1,608,890                      | \$ 11.12                                 | 1,704,665                      | \$ 11.20                                 |

The following table summarizes the stock options outstanding as well as stock options vested and exercisable as of December 31, 2013 and 2012:

| Range of<br>Exercise<br>Prices | December 31, 2013<br>Options Outstanding |   |  |                                 | Options Vested and Exercisable |   |  |                                 |
|--------------------------------|--|---|--|---------------------------------|--------------------------------|---|--|---------------------------------|
|                                | Number<br>Outstanding                    | Weighted<br>Average<br>Remaining<br>Contractual<br>Life in<br>Years | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value | Number<br>Exercisable          | Weighted<br>Average<br>Remaining<br>Contractual<br>Life in<br>Years | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value |
| \$6.05 - \$10.00               | 2,370,290                                | 6.61  | \$ 7.54                                  | \$ 1,812,250                    | 820,290                        | 1.86  | \$ 10.00                                 | \$ -                            |

| Range of | December 31, 2012<br>Options Outstanding |   |  | Options Vested and Exercisable  |                       |   |  |
|----------|--|---|--|---------------------------------|-----------------------|---|--|
|          | Number<br>Outstanding                    | Weighted<br>Average<br>Remaining<br>Contractual<br>Life in<br>Years | Weighted<br>Average<br>Exercise<br>Price | Aggregate<br>Intrinsic<br>Value | Number<br>Exercisable | Weighted<br>Average<br>Remaining<br>Contractual<br>Life in<br>Years | Weighted<br>Average<br>Exercise<br>Price |
|          |  |   |  |                                 |                       |   |  |

| <b>Exercise Prices</b> | <b>Number Outstanding</b> | <b>Contractual Life in Years</b> | <b>Exercise Price</b> | <b>Intrinsic Value</b> | <b>Number Exercisable</b> | <b>Contractual Life in Years</b> | <b>Exercise Price</b> | <b>Intrinsic Value</b> |
|------------------------|---------------------------|----------------------------------|-----------------------|------------------------|---------------------------|----------------------------------|-----------------------|------------------------|
| \$10.00 - \$12.50      | 1,608,890                 | 2.06                             | \$ 11.12              | \$ -                   | 1,608,890                 | 2.06                             | \$ 11.12              | \$ -                   |

The Company recognizes stock-based compensation expense for stock options over the vesting period using the accelerated attribution method when they are subject to graded vesting and on a straight-line basis when they are subject to cliff vesting. The Company recognized compensation expense related to stock options of \$0.9 million, zero and zero for the years ended December 31, 2013, 2012 and 2011.

As of December 31, 2013, there was \$2.3 million unrecognized compensation expense related to stock options. As of December 31, 2012, there was no unrecognized compensation expense related to stock options.

There were no stock options exercised during the years ended December 31, 2013, 2012 and 2011. As a result, the Company did not recognize any current income tax benefits from exercise of stock options during these periods.

The Company uses Black-Scholes option-pricing model or other quantitative models to calculate the fair value of option awards.

In February 2013, the Company granted stock options to purchase approximately 1.6 million shares of the Company's common stock to certain employees for long-term incentive purposes. The options have an exercise price ranging from \$6.05 to \$6.24 per share, an exercise period of 5.9 years and a Company performance-based condition as well as a three-year requisite service period. The fair value of these options was determined using a quantitative model using the following assumptions: expected life of 5.9 years, risk-free interest rate of 1.08%, dividend yield of 2.2% and volatility of 50.0%. The risk-free rate was interpolated from the U.S. constant maturity treasuries for a term corresponding to the maturity of the option. The volatility was calculated from the historical weekly stock prices of the Company as of the grant date for a term corresponding to the maturity of the option. The dividend yield was calculated as the sum of the last twelve-month dividends over the stock price as of the grant date.

#### *Restricted Stock Units and Restricted Shares*

In 2011, the Company issued 1,073,583 RSUs under the JMP Group 2007 Plan, which was comprised of 921,876 performance-based RSUs granted on January 31, 2011 to certain employees for long term incentive purposes (the "2011 performance-based RSUs"), 144,505 RSUs granted to certain new employees and 7,202 RSUs granted to the Company's independent directors. The 2011 performance-based RSUs had Company performance-based vesting conditions and were to vest if the Company performance target set for such RSUs is met during any of the years ending December 31, 2011, 2012 or 2013. In the fourth quarter of 2011, the vesting of all of the 2011

performance-based RSUs became probable based on the Company's operating results for the year 2011, and the Company recognized \$6.1 million of compensation expense for such RSUs in the quarter. In the first quarter of 2012, the 2011 performance-based RSUs vested but remained subject to post-vesting transfer restrictions until December 31, 2013. Therefore, the fair value of the 2011 performance-based RSUs was determined based on the closing price of the Company's stock on the grant date with a liquidity discount of 15% for the post-vesting restrictions. The liquidity discount for the post-vesting restrictions was determined based on a quantitative model using the following assumptions: expected holding period of 2 years, dividend yield of 0.0%, volatility of 40.0% and risk-free interest rate of 0.26%. The dividend yield of 0.0% was used because these RSUs received dividends during the post-vesting restriction period. The risk-free rate was interpolated from the U.S. constant maturity treasuries for a term corresponding to the expected holding period. The volatility was calculated from the historical weekly stock prices of the Company and comparable companies for a term corresponding to the holding period.

The RSUs granted to certain new employees and the Company's independent directors in 2011 had vesting periods ranging from one to three years. The fair value of those RSUs was determined based on the closing price of the Company's stock on the grant date discounted for dividends not received during the vesting period using assumed dividend rate ranging from \$0.02 to \$0.03 per quarter and risk-free interest rate ranging from 0.25% to 1.01%.

In February 2012, the Company granted 910,000 RSUs to certain employees for long term incentive purposes. These units have Company performance-based condition and a three-year requisite service period and will vest when both conditions are met. The fair value of these RSUs was determined based on the closing price of the Company's stock on the grant date, discounted for dividends not received during the vesting period using assumed dividend rate of \$0.035 per quarter and risk-free interest rate of 0.35%. In the fourth quarter of 2012, the vesting of these RSUs became probable based on the Company's operating results for the year 2012, and the Company recognized \$1.8 million of compensation expense for such RSUs in the quarter. The remaining compensation expense related to these RSUs will be recognized over the remaining vesting period of two years.

On February 11, 2013, the Company granted approximately 560,000 RSUs to certain employees for long-term incentive purposes. In addition, approximately 110,000 and 446,000 RSUs were granted in 2013 to certain employees as deferred compensation and as hiring bonuses, respectively. These RSUs have requisite service periods of two to three years and receive cash dividend equivalents during the vesting periods. The fair value of these RSUs was determined based on the closing price of the Company's stock on the grant date without any discount.

The following table summarizes the RSU activity for the years ended December 31, 2013, 2012 and 2011:

|                            | Year Ended December 31,<br>2013 |  | 2012                         |  | 2011                         |  |
|----------------------------|---------------------------------|--|------------------------------|--|------------------------------|--|
|                            | Restricted<br>Stock<br>Units    | Weighted<br>Average<br>Grant<br>Date Fair<br>Value | Restricted<br>Stock<br>Units | Weighted<br>Average<br>Grant<br>Date Fair<br>Value | Restricted<br>Stock<br>Units | Weighted<br>Average<br>Grant<br>Date Fair<br>Value |
| Balance, beginning of year | 1,020,382                       | \$ 7.27  | 1,634,268                    | \$ 7.42  | 1,630,026                    | \$ 8.52  |
| Granted                    | 1,115,505                       | 6.22   | 952,597                      | 7.29   | 1,073,583                    | 7.43   |
| Vested                     | (118,173 )                      | 6.73   | (1,456,540)                  | 7.00   | (1,039,082)                  | 9.14   |
| Forfeited                  | (136,565 )                      | 7.01   | (109,943 )                   | 6.89   | (30,259 )                    | 8.11   |
| Balance, end of period     | 1,881,149                       | \$ 6.70  | 1,020,382                    | \$ 7.27  | 1,634,268                    | \$ 7.42  |

The aggregate fair value of RSUs vested during the years ended December 31, 2013, 2012 and 2011 were \$0.8 million, \$10.2 million and \$8.4 million, respectively. The income tax benefits realized from the vested RSUs were \$0.3 million, \$3.7 million and \$3.0 million, respectively.

The Company recognizes compensation expense for RSUs over the vesting period using the accelerated attribution method when they are subject to graded vesting and on a straight-line basis when they are subject to cliff vesting. For the years ended December 31, 2013, 2012 and 2011, the Company recorded compensation expense related to RSUs of

\$4.4 million, \$2.5 million, and \$10.3 million respectively. For the year ended December 31, 2012, the compensation expense related to RSUs awarded included \$1.8 million recognized on the probable vesting of the performance-based RSUs granted in February 2012, described above. For the year ended December 31, 2011, the compensation expense related to RSUs awarded included \$6.1 million recognized on the probable vesting of 100.0% of the 2011 performance-based RSUs described above.

For the years ended December 31, 2013, 2012 and 2011, the Company recognized income tax benefits of \$2.1 million, \$0.9 million and \$4.2 million, respectively, related to the compensation expense recognized for RSUs. As of December 31, 2013 and 2012, there was \$6.5 million and \$4.8 million, respectively, of unrecognized compensation expense related to RSUs expected to be recognized over a weighted average period of 1.51 years and 1.87 years, respectively.

The Company pays cash dividend equivalents on certain unvested RSUs. Dividend equivalents paid on RSUs are generally charged to retained earnings. Dividend equivalents paid on RSUs expected to be forfeited are included in compensation expense. The Company accounts for the tax benefit related to dividend equivalents paid on RSUs as an increase on additional paid-in capital.

#### **11. 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 the Company has 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 per share and basic and diluted net income (loss) per unit for the years ended December 31, 2013, 2012 and 2011 are shown in the table below:

| <i>(In thousands, except per share data)</i>     | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2013</b>                    | <b>2012</b> | <b>2011</b> |
| <i>Numerator:</i>                                |                                |             |             |
| Net income (loss) attributable to JMP Group, Inc | \$3,628                        | \$2,757     | \$(2,456 )  |
| <i>Denominator:</i>                              |                                |             |             |
| Basic weighted average shares outstanding        | 22,158                         | 22,582      | 22,118      |
| Effect of potential dilutive securities:         |                                |             |             |
| Restricted stock units                           | 1,159                          | 324         | -           |
| Diluted weighted average shares outstanding      | 23,317                         | 22,906      | 22,118      |
| Net income (loss) per share                      |                                |             |             |
| Basic  | \$0.16                         | \$0.12      | \$(0.11 )   |
| Diluted  | \$0.16                         | \$0.12      | \$(0.11 )   |

In the table above, unvested non-forfeitable RSUs that have dividend equivalent rights are treated as a separate class of securities in calculated net income (loss) per share. The impact of applying this methodology was a reduction in basic net income per share of less than \$0.01 for 2013 and zero for both 2012 and 2011.

Stock options to purchase 2,794,534, 1,642,841 and 1,755,131 shares of common stock for the years ended December 31, 2013, 2012 and 2011, respectively, were anti-dilutive and, therefore, were not included in the computation of diluted weighted-average common shares outstanding.

Stock options to purchase 1,412,192 and zero shares of common stock for the years ended December 31, 2013, 2012 and 2011, respectively, had a Company performance-based condition and were not included in the computation of diluted weighted-average common shares outstanding because such performance-based condition has not been met.

Restricted stock units for 75,255, zero and 71,883 shares of common stock for the years ended December 31, 2013, 2012 and 2011, respectively, were anti-dilutive and, therefore, were not included in the computation of diluted weighted-average common shares outstanding.

**12. 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 years ended December 31, 2013, 2012 and 2011.

**13. Income Taxes**

The components of the Company's income tax expense (benefit) for the years ended December 31, 2013, 2012 and 2011 are as follows:

| <i>(In thousands)</i>                       | <b>Year Ended December</b> |             |             |
|---|----------------------------|-------------|-------------|
|   | <b>31,</b>                 |             |             |
|   | <b>2013</b>                | <b>2012</b> | <b>2011</b> |
| Federal                                     | \$8,789                    | \$2,714     | \$3,725     |
| State                                       | 715                        | (791 )      | 278         |
| Total current income tax expense            | 9,504                      | 1,923       | 4,003       |
| Federal                                     | (5,154)                    | (814 )      | (4,795)     |
| State                                       | (400 )                     | 472         | (840 )      |
| Total deferred income tax expense (benefit) | (5,554)                    | (342 )      | (5,635)     |
| Total income tax expense (benefit)          | \$3,950                    | \$1,581     | \$(1,632)   |



A reconciliation of the statutory U.S. federal income tax rate to the effective tax rate for the years ended December 31, 2013, 2012 and 2011 is as follows:

|  | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2013</b>                    | <b>2012</b> | <b>2011</b> |
| Tax at federal statutory tax rate  | 35.00 %                        | 34.00 %     | 35.00 %     |
| State income tax, net of federal tax benefit (1)   | 3.82 %                         | 6.67 %      | 19.76 %     |
| Change in New York valuation (1)   | -1.06 %                        | -3.70 %     | -14.01 %    |
| Adjustment for permanent items (HGC, HGC II, HCC LLC, CLO II and HCAP Advisors non-controlling interest) (2) | -19.84 %                       | -17.55 %    | -6.89 %     |
| Adjustment for other permanent items   | -0.55 %                        | 0.20 %      | -2.72 %     |
| Rate before one-time events  | 17.37 %                        | 19.62 %     | 31.14 %     |
| Deferred tax asset written off related to options and RSUs   | 4.11 %                         | 0.31 %      | -3.48 %     |
| Adjustment for prior year taxes  | -0.55 %                        | -1.15 %     | 5.95 %      |
| California state enterprise zone tax credit  | -0.97 %                        | -2.20 %     | 4.83 %      |
| Adjustment for capitalized costs   | 2.54 %                         | 0.00 %      | 0.00 %      |
| Effective tax rate   | 22.50 %                        | 16.58 %     | 38.44 %     |

(1) HCC LLC (through May 2, 2013), CLO II (effective April 30, 2013), HCAP Advisors (effective May 1, 2013), HGC, and HGC II are consolidated for financial reporting purposes but not for tax purposes.

The increase in the effective tax rate for the year ended December 31, 2013 compared to the same period in 2012 was primarily attributable to the deferred tax written off related to options and RSUs and the capitalization of stock issuance costs. The effective interest rate is low as it is calculated using tax expense related to the Company divided by income before non-controlling interest.

As of December 31, 2013 and 2012, the components of deferred tax assets and liabilities are as follows:

| <i>(In thousands)</i>                     | <b>As of December</b> |             |
|---|-----------------------|-------------|
|   | <b>31,</b>            |             |
|   | <b>2013</b>           | <b>2012</b> |
| Deferred tax assets:                      |                       |             |
| Accrued compensation and related expenses | \$4,391               | \$5,829     |
| Equity based compensation                 | 2,860                 | 2,010       |
| Reserves and allowances                   | 2,043                 | 3,661       |
| New York net operating loss               | 495                   | 715         |
| Liquidity discount at JMP Credit          | -                     | 1,537       |
| Deferred compensation                     | 1,992                 | 823         |
| Other                                     | 1,734                 | 604         |
| Total deferred tax assets                 | 13,515                | 15,179      |

## Deferred tax liabilities:

|   |          |           |
|---|----------|-----------|
| Investment in partnerships                        | (517 )   | (1,608 )  |
| Repurchase of asset-backed securities issued      | (1,647 ) | (1,600 )  |
| Liquidity discount at JMP Credit                  | -        | (5,747 )  |
| Depreciation and amortization                     | (141 )   | (262 )    |
| Net unrealized capital gains/losses               | (1,249 ) | (1,296 )  |
| Interest in HCC LLC (1)                           | (71 )    | (188 )    |
| Total deferred tax liabilities                    | (3,625 ) | (10,701 ) |
| Net deferred tax asset before valuation allowance | 9,890    | 4,478     |
| Valuation allowance                               | (1,009 ) | (1,166 )  |
| Net deferred tax assets                           | \$8,881  | \$3,312   |

(1) HCC LLC was consolidated for financial reporting purposes (through May 2, 2013) but not consolidated for tax reporting purposes.

As of December 31, 2013, JMP Group Inc. has a New York State and City net operating loss (“NOL”) carry forward of approximately \$21.3 million, which expires between 2029 and 2032. The NOL has a full valuation allowance against it.

The valuation allowance decreased \$0.2 million in fiscal year 2013 and \$0.4 million in the prior year.

With the exception of the New York State and City deferred tax asset, the Company has determined that a valuation allowance against any other deferred tax assets was not necessary as of December 31, 2013, 2012 and 2011. Management believes that the deferred tax assets will, more-likely-than-not, be realized based on taxes paid in prior years and future reversing taxable temporary differences. The Company has analyzed the filing positions in its Federal and state income tax returns for all open tax years, which are 2010 and 2012 for federal income tax purposes and 2009 through 2012 for California income tax purposes.

The Company files its tax returns as prescribed by the tax laws of the jurisdictions in which it operates; with the limited exception of certain jurisdictions which do not have a significant adverse effect on the Company’s overall tax exposure. The Company recognizes tax benefits related to its tax positions only where the position is “more likely than not” to be sustained in the event of examination by tax authorities. As part of its assessment, the Company analyzes its tax filing positions in all of the federal, state and foreign tax jurisdictions where it is required to file income tax returns, and for all open tax years in these jurisdictions. As of December 31, 2013, the total reserve balance including interest and penalties was \$0.1 million. The Company is not currently under examination in any tax jurisdictions and 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 within the next twelve months.



## 14. Commitments and Contingencies

The Company leases office space in California, Illinois, Georgia, Massachusetts, Minnesota, New York and Pennsylvania under various operating leases. Rental expense was \$3.4 million for both the years ended December 31, 2013 and 2012, and \$2.9 million for the year ended December 31, 2011. The Company recorded sublease income of \$0.2 million for both the years ended December 31, 2013 and 2012, and \$0.6 million for the year ended December 31, 2011.

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

| <i>(In thousands)</i> | <b>December<br/>31, 2013</b> |
|-----------------------|------------------------------|
| 2014                  | 4,082                        |
| 2015                  | 4,087                        |
| 2016                  | 4,052                        |
| 2017                  | 3,447                        |
| 2018                  | 2,254                        |
| Thereafter            | 904                          |
|                       | <b>\$ 18,826</b>             |

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 December 31, 2013 and 2012, 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 both December 31, 2013 and 2012, the Company had \$150,000 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 December 31, 2013 and 2012, the Company had unfunded commitments of \$40.4 million and \$18.6 million in the Corporate Credit segment, respectively. \$8.7 million of the unfunded commitments as of December 31, 2013 relate to commitments traded but not yet closed in CLO II. \$10.4 million of the unfunded commitments as of December 31,

2013 relate to commitments traded but not yet closed in CLO III. The Company determined the fair value of the unfunded commitments to be \$41.0 million and \$18.9 million as of December 31, 2013 and 2012, using the average market bid and ask quotation obtained from a loan pricing service.

## 15. 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 \$59.1 million and \$36.7 million, which were \$58.1 million and \$35.7 million in excess of the required net capital of \$1.0 million at December 31, 2013 and 2012, respectively. JMP Securities' ratio of aggregate indebtedness to net capital was 0.16 to 1 and 0.17 to 1 at December 31, 2013 and 2012, 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.

## 16. Related Party Transactions

The Company earns base management fees and incentive fees from serving as investment advisor for various entities, including corporations, partnerships limited liability companies, and offshore investment companies. The Company also owns an investment in most of such affiliated entities. As of December 31, 2013 and 2012, the aggregate fair value of the Company's investments in the affiliated entities for which the Company serves as the investment advisor was \$55.3 million and \$28.0 million, respectively, which consisted of investments in hedge and other private funds of \$44.6 million and \$27.9 million, respectively, investments in funds of funds of \$0.1 million for both years, and an investment in HCC common stock of \$10.6 million and zero, respectively. Base management fees earned from these affiliated entities were \$10.8 million, \$9.4 million and \$9.7 million for the years ended December 31, 2013, 2012 and 2011, respectively. Also, the Company earned incentive fees of \$15.1 million, \$6.3 million and \$10.1 million from these affiliated entities for the years ended December 31, 2013, 2012 and 2011, respectively. As of December 31, 2013 and 2012, the Company had incentive fees receivable from these entities of \$7.9 million and \$2.9 million, respectively.

## 17. 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 December 31, 2013 had settled with no resulting material liability to the Company. For the years ended December 31, 2013, 2012 and 2011, the Company had no material loss due to counterparty failure, and has no obligations outstanding under the indemnification arrangement as of December 31, 2013.

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.

## 18. Litigation

The Company is involved in a number of judicial, regulatory and arbitration matters arising in connection with our business. The outcome of matters the Company has been and currently is 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. The Company 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.

The Company reviews 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, given the inherent difficulty of predicting the outcome of matters the Company is involved in, particularly 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. For these matters, no reserve is established until such time, other than for reasonably estimable legal fees and expenses. 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.

## **19. 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 CLOs, 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. In its Corporate Credit segment, the Company had unfunded commitments of \$40.4

million and standby letters of credit of \$1.8 million at December 31, 2013. In its Corporate Credit segment, the Company had unfunded commitments of \$18.6 million and standby letters of credit of \$1.0 million at December 31, 2012.



## 20. Business Segments

The Company's business results are categorized into the following five business segments: Broker-Dealer, Asset Management, Corporate Credit, Investment Income and Corporate Costs. The Broker-Dealer segment includes a broad range of services, such as underwriting and acting as a placement agent for public and private capital markets 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, hedge funds of funds. The Corporate Credit segment includes the management of collateralized loan obligations and small business loans. The Investment Income segment includes income from the Company's principal investments in public and private securities, as well as any other net interest and income from investing activities. The Corporate Costs segment includes expenses related to JMP Group Inc., the holding company, and JMP Group LLC, and is mainly comprised of corporate overhead expenses and interest expense related to the Company's credit facility with City National Bank.

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

Management uses Adjusted Operating Net Income as a key metric when evaluating the performance of JMP Group's core business strategy and ongoing operations. Adjusted Operating Net Income is a non-GAAP financial measure that adjusts the Company's net income as follows: (i) reverses non-cash stock-based compensation expense related to equity awards granted both at the time of JMP Group's May 2007 initial public offering and thereafter, (ii) recognizes 100% of the cost of deferred compensation in the period for which such compensation was awarded, instead of recognizing such cost over the vesting period as required under GAAP, (iii) excludes the net amortization of liquidity discounts on loans held and asset-backed securities issued by JMP Credit Corporation, (iv) excludes amortization expense related to an intangible asset, (v) reverses net unrealized gains and losses on strategic equity investments and warrants, (vi) excludes unrealized mark-to-market gains or losses on the investment portfolio at HCC LLC, (vii) includes a non-recurring expense of \$450,000 in connection with the initial public offering of HCC on May 2, 2013, (viii) excludes gains or losses recognized by JMP Credit Corporation due to the sale or payoff of loans originally included in the portfolio acquired by JMP Group in April 2009, (ix) excludes general loan loss reserves on CLO II, and (x) presents revenues and expenses on a basis that deconsolidates HGC, HGC II and HCC LLC. HGC and HGC II are excluded as we own a relatively small percentage of these funds, although they are consolidated. These charges may otherwise obscure the company's operating income and complicate an assessment of the company's core business activities. The operating pre-tax net income facilitates a meaningful comparison of the Company's results in a given period to those in prior and future periods. The revenues and expenses are presented on a basis that deconsolidates the investment funds Harvest manages.

The Company's segment information for the years ended December 31, 2013, 2012 and 2011 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.

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.

**Segment Operating Results**

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

| <i>(In thousands)</i>                              | <b>Year Ended December 31,</b> |             |             |
|--|--------------------------------|-------------|-------------|
|  | <b>2013</b>                    | <b>2012</b> | <b>2011</b> |
| <b>Broker-Dealer</b>                               |                                |             |             |
| Non-interest revenues                              | \$99,133                       | \$73,130    | \$71,738    |
| Total net revenues after provision for loan losses | \$99,133                       | \$73,130    | \$71,738    |
| Non-interest expenses                              | 84,785                         | 67,152      | 68,853      |
| Segment operating pre-tax net income               | \$14,348                       | \$5,978     | \$2,885     |
| Segment assets                                     | \$109,437                      | \$66,611    | \$69,924    |
| <b>Asset Management</b>                            |                                |             |             |
| Non-interest revenues                              | \$29,598                       | \$23,177    | \$23,812    |
| Total net revenues after provision for loan losses | \$29,598                       | \$23,177    | \$23,812    |
| Non-interest expenses                              | 29,628                         | 20,686      | 20,254      |
| Non-controlling interest                           | (1,731 )                       | -           | -           |
| Segment operating pre-tax net income               | \$1,701                        | \$2,491     | \$3,558     |
| Segment assets                                     | \$134,471                      | \$57,423    | \$91,181    |
| <b>Corporate Credit</b>                            |                                |             |             |
| Non-interest revenues                              | \$4,735                        | \$4,064     | \$6,013     |
| Total net revenues after provision for loan losses | \$4,735                        | \$4,064     | \$6,013     |
| Non-interest expenses                              | 3,691                          | 2,996       | 4,585       |
| Segment operating pre-tax net income               | \$1,044                        | \$1,068     | \$1,428     |
| Segment assets                                     | \$17,207                       | \$5,415     | \$4,857     |
| <b>Investment Income</b>                           |                                |             |             |
| Non-interest revenues                              | \$11,128                       | \$8,442     | \$4,669     |
| Net interest income                                | 16,470                         | 19,314      | 21,332      |
| Provision for loan losses                          | (51 )                          | (184 )      | (35 )       |
| Total net revenues after provision for loan losses | \$27,547                       | \$27,572    | \$25,966    |
| Non-interest expenses                              | 5,224                          | (4,130 )    | 112         |
| Non-controlling interest                           | 981                            | 670         | 590         |
| Segment operating pre-tax net income               | \$21,342                       | \$31,032    | \$25,264    |
| Segment assets                                     | \$805,601                      | \$518,283   | \$483,423   |
| <b>Corporate Costs</b>                             |                                |             |             |
| Non-interest expenses                              | 16,039                         | 13,647      | 11,461      |
| Segment operating pre-tax net loss                 | \$(16,039 )                    | \$(13,647 ) | \$(11,461 ) |
| Segment assets                                     | \$187,838                      | \$159,233   | \$133,391   |
| <b>Eliminations</b>                                |                                |             |             |
| Non-interest revenues                              | \$(5,764 )                     | \$(5,419 )  | \$(5,107 )  |
| Total net revenues after provision for loan losses | \$(5,764 )                     | \$(5,419 )  | \$(5,107 )  |
| Non-interest expenses                              | (5,744 )                       | (5,419 )    | (5,086 )    |
| Segment operating pre-tax net loss                 | \$(20 )                        | \$-         | \$(21 )     |

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|  |              |             |             |
|--|--------------|-------------|-------------|
| Segment assets                                     | \$(132,622 ) | \$(97,102 ) | \$(122,111) |
| Total Segments                                     |              |             |             |
| Non-interest revenues                              | \$138,830    | \$103,394   | \$101,125   |
| Net interest income                                | 16,470       | 19,314      | 21,332      |
| Provision for loan losses                          | (51 )        | (184 )      | (35 )       |
| Total net revenues after provision for loan losses | \$155,249    | \$122,524   | \$122,422   |
| Non-interest expenses                              | 133,623      | 94,932      | 100,179     |
| Non-controlling interest                           | (750 )       | 670         | 590         |
| Segment operating pre-tax net income               | \$22,376     | \$26,922    | \$21,653    |
| Total assets                                       | \$1,121,932  | \$709,863   | \$660,665   |

The following tables reconcile the total segments to consolidated net income before income tax expense and total assets as of and for the years ended December 31, 2013, 2012 and 2011.

(In thousands)

**As of and Year Ended December 31, 2013**

|  | <b>Total<br/>Segments</b> | <b>Consolidation<br/>Adjustments<br/>and<br/>Reconciling<br/>Items</b> | <b>JMP<br/>Consolidated</b> |
|--|---------------------------|--|-----------------------------|
| Non-interest revenues                              | \$ 138,830                | \$ 9,786   | (a) \$ 148,616              |
| Net Interest Income                                | 16,470                    | (13,234)   | (b) 3,236                   |
| Provision for loan losses                          | (51)                      | (2,586)  | (2,637)                     |
| Total net revenues after provision for loan losses | \$ 155,249                | \$ (6,034)   | \$ 149,215                  |
| Non-interest expenses                              | 133,623                   | (1,959)  | (c) 131,664                 |
| Noncontrolling interest                            | (750)                     | 10,723   | 9,973                       |
| Operating pre-tax net income (loss)                | \$ 22,376                 | \$ (14,798)  | (d) \$ 7,578                |
| Total assets                                       | \$ 1,121,932              | \$ -   | \$ 1,121,932                |

(In thousands)

**As of and Year Ended December 31, 2012**

|  | <b>Total<br/>Segments</b> | <b>Consolidation<br/>Adjustments<br/>and<br/>Reconciling<br/>Items</b> | <b>JMP<br/>Consolidated</b> |
|--|---------------------------|--|-----------------------------|
| Non-interest revenues                              | \$ 103,394                | \$ 6,829   | (a) \$ 110,223              |
| Net Interest Income                                | 19,314                    | (26,409)   | (b) (7,095)                 |
| Provision for loan losses                          | (184)                     | (2,022)  | (2,206)                     |
| Total net revenues after provision for loan losses | \$ 122,524                | \$ (21,602)  | \$ 100,922                  |
| Non-interest expenses                              | 94,932                    | (3,544)  | (c) 91,388                  |
| Noncontrolling interest                            | 670                       | 4,526  | 5,196                       |
| Operating pre-tax net income (loss)                | \$ 26,922                 | \$ (22,584)  | (d) \$ 4,338                |
| Total assets                                       | \$ 709,863                | \$ -   | \$ 709,863                  |

(In thousands)

**As of and Year Ended December 31, 2011**

|  | <b>Total<br/>Segments</b> | <b>Consolidation<br/>Adjustments<br/>and<br/>Reconciling<br/>Items</b> | <b>JMP<br/>Consolidated</b> |
|--|---------------------------|--|-----------------------------|
| Non-interest revenues                              | \$ 101,125                | \$ 14,548  | (a) \$ 115,673              |
| Net Interest Income                                | 21,332                    | (23,723)   | (b) (2,391)                 |
| Provision for loan losses                          | (35)                      | (1,693)  | (1,728)                     |
| Total net revenues after provision for loan losses | \$ 122,422                | \$ (10,868)  | \$ 111,554                  |
| Non-interest expenses                              | 100,179                   | 15,620   | (c) 115,799                 |

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|                                     |           |            |      |            |   |
|-------------------------------------|-----------|------------|------|------------|---|
| Noncontrolling interest             | 590       | (747       | )    | (157       | ) |
| Operating pre-tax net income (loss) | \$21,653  | \$ (25,741 | )(d) | \$ (4,088  | ) |
| Total assets                        | \$660,665 | \$ -       |      | \$ 660,665 |   |

(a) Non-interest revenue adjustments are comprised of loan sale gains, mark-to-market gains/losses, strategic equity investments and warrants, and fund-related revenues recognized upon consolidation of certain Harvest Funds.

(b) The Net Interest Income adjustment is comprised of the non-cash net amortization of liquidity discounts at JPM Credit, due to scheduled contractual repayments, and amortization expense related to an intangible asset.

(c) Non-interest expense adjustments relate to reversals of stock-based compensation and exclusion of fund-related expenses recognized upon consolidation of certain Harvest Funds.

(d) Reconciling operating pre-tax net income to Consolidated Net Income before income tax expense in the Consolidated Statements of Operations consists of the following:

*(In thousands)*

|   | <b>Year Ended December 31,</b> |                |                   |
|---|--------------------------------|----------------|-------------------|
|   | <b>2013</b>                    | <b>2012</b>    | <b>2011</b>       |
| <b>Total Segments adjusted operating pre-tax net income</b>                         | \$22,377                       | \$26,921       | \$21,654          |
| Subtract / (Add back)   |                                |                |                   |
| Stock options / IPO RSU expense   | 920                            | -              | 778               |
| Compensation expense - post-IPO RSUs  | 2,823                          | 2,492          | 9,526             |
| Deferred compensation program accounting adjustment                                 | (6,170 )                       | (6,985 )       | -                 |
| HCC IPO administrative expense  | 450                            | (450 )         | -                 |
| Net unrealized loss/ (gain) on strategic equity investments and warrants.           | (596 )                         | 527            | (441 )            |
| General loan loss reserve for CLO II  | 1,241                          | -              | -                 |
| Net amortization of liquidity discounts on loans and asset-backed securities issued | 14,979                         | 29,208         | 23,522            |
| Amortization of intangible asset  | -                              | -              | 200               |
| Unrealized mark-to-market (gain)/loss - HCC   | 610                            | (627 )         | 17                |
| Gain on loan portfolio acquired   | 542                            | (1,582 )       | (7,860 )          |
| <b>Consolidated pre-tax net income (loss) attributable to JMP Group Inc.</b>        | <b>\$7,578</b>                 | <b>\$4,338</b> | <b>\$(4,088 )</b> |
| Income tax expense (benefit)  | 3,950                          | 1,581          | (1,632 )          |
| <b>Consolidated Net Income (Loss) attributable to JMP Group Inc.</b>                | <b>\$3,628</b>                 | <b>\$2,757</b> | <b>\$(2,456 )</b> |

## 21. Summarized financial information for equity method investments

The tables below present summarized financial information of the hedge funds which the Company accounts for under the equity method. The financial information below represents 100% of the net assets, net realized and unrealized gains (losses) and net investment income (loss) of such hedge funds as of the dates and for the periods indicated.

| <i>(In thousands)</i>           | <b>As of December 31,</b> |                       |
|---------------------------------|---------------------------|-----------------------|
|                                 | <b>2013</b>               | <b>2012</b>           |
|                                 | <b>Net<br/>Assets</b>     | <b>Net<br/>Assets</b> |
| Harvest Opportunity Partners II | \$95,362                  | \$84,852              |
| Harvest Small Cap Partners      | 321,714                   | 288,391               |
| Harvest Franchise Fund          | 114,145                   | 84,192                |
| Harvest Agriculture Select      | 43,089                    | 18,162                |
| Harvest Technology Partners     | 42,661                    | 32,689                |
| Harvest Diversified Partners    | -                         | 23,598                |

*(In thousands)*

| <b>Year Ended December 31,</b> |                   |                        |                   |                        |                   |
|--------------------------------|-------------------|------------------------|-------------------|------------------------|-------------------|
| <b>2013</b>                    |                   | <b>2012</b>            |                   | <b>2011</b>            |                   |
| <b>Net</b>                     | <b>Net</b>        | <b>Net</b>             | <b>Net</b>        | <b>Net</b>             | <b>Net</b>        |
| <b>Realized</b>                | <b>Investment</b> | <b>Realized</b>        | <b>Investment</b> | <b>Realized</b>        | <b>Investment</b> |
| <b>and</b>                     | <b>Income</b>     | <b>and</b>             | <b>Income</b>     | <b>and</b>             | <b>Income</b>     |
| <b>Unrealize(Loss)</b>         | <b>(Loss)</b>     | <b>Unrealize(Loss)</b> | <b>(Loss)</b>     | <b>Unrealize(Loss)</b> | <b>(Loss)</b>     |

|                                 | <b>Gains<br/>(Losses)</b> |             | <b>Gains<br/>(Losses)</b> |             | <b>Gains<br/>(Losses)</b> |             |
|---------------------------------|---------------------------|-------------|---------------------------|-------------|---------------------------|-------------|
| Harvest Opportunity Partners II | \$7,091                   | \$ (1,366 ) | \$11,752                  | \$ (1,300 ) | \$2,100                   | \$ (1,661 ) |
| Harvest Small Cap Partners      | 70,713                    | (21,173 )   | 42,478                    | (21,096 )   | 63,139                    | (19,588 )   |
| Harvest Franchise Fund          | 26,472                    | (4,039 )    | (7,267 )                  | (215 )      | -                         | -           |
| Harvest Agriculture Select      | 3,838                     | (478 )      | 3,172                     | (298 )      | (158 )                    | (308 )      |
| Harvest Technology Partners     | 752                       | (761 )      | (577 )                    | (1,032 )    | 2,149                     | (722 )      |
| Harvest Diversified Partners    | 1,563                     | (435 )      | 2,626                     | (417 )      | 1,071                     | (726 )      |

## 22. Subsequent Events

In January 2014, the Company issued \$48.3 million principal amount of 7.25% senior notes (the “2014 Senior Notes”). The 2014 Senior Notes will mature on January 15, 2021, and may be redeemed in whole or in part at any time or from time to time at the company’s option on or after January 15, 2017, at a redemption price equal to the principal amount redeemed plus accrued and unpaid interest. The 2014 Senior Notes will bear interest at a rate of 7.25% per year, payable quarterly on January 15, April 15, July 15 and October 15 of each year, beginning on April 15, 2014.

On February 5, 2014, the Company granted approximately 334,000 RSUs to certain employees for long-term incentive purposes. Such RSUs have a required service period of three years and will vest on December 31, 2016 provided that employees provide continuous service through that date.

On February 11, 2014, the Company granted approximately 428,000 RSUs to certain employees as part of the 2013 annual compensation program. 50% of these units will vest on each of December 31, 2014 and December 31, 2015 provided that employees provide continuous service through those dates.

On February 5, 2014 and February 10, 2014, the Company granted stock options to purchase approximately 1.4 million shares of the Company’s common stock to certain employees for long-term incentive purposes. On March 11, 2014, the Company granted stock options to purchase 110,000 shares of the Company’s common stock to its independent directors. Both of these stock options have a Company performance-based condition and a three-year service condition and will vest when both of the conditions are met.



On March 11, 2014, the Company's board of directors declared a cash dividend of \$0.045 per share of common stock for the fourth quarter of 2013 to be paid on April 11, 2014, to common stockholders of record on March 28, 2014.

### 23. Selected Quarterly Financial Data (Unaudited)

The following represents the Company's unaudited quarterly results for the years ended December 31, 2013 and 2012. These quarterly results were prepared in accordance with GAAP and reflect all adjustments that are in the opinion of management, necessary for a fair statement of the results.

|  | <b>JMP Group Inc.</b>                       |                  |             |              |
|--|---|------------------|-------------|--------------|
|  | <b>Selected Consolidated Financial Data</b> |                  |             |              |
|  | <b>Three Months Ended</b>                   |                  |             |              |
|  | <b>December</b>                             | <b>September</b> | <b>June</b> | <b>March</b> |
|  | <b>31,</b>                                  | <b>30, 2013</b>  | <b>30,</b>  | <b>31,</b>   |
|  | <b>2013</b>                                 |                  | <b>2013</b> | <b>2013</b>  |
| <i>(In thousands, except per share data)</i>                         |   |                  |             |              |
| Total net revenues after provision for loan losses                   | \$59,686                                    | \$ 35,377        | \$30,904    | \$23,248     |
| Non-interest expenses:   |   |                  |             |              |
| Compensation and benefits  | 33,366                                      | 24,685           | 24,776      | 19,605       |
| Other expenses   | 7,297                                       | 6,786            | 8,983       | 6,166        |
| Total non-interest expenses  | 40,663                                      | 31,471           | 33,759      | 25,771       |
| Income (loss) before income tax expense                              | 19,023                                      | 3,906            | (2,855 )    | (2,523 )     |
| Income tax expense (benefit)   | 3,772                                       | 1,634            | (644 )      | (812 )       |
| Net income (loss)  | 15,251                                      | 2,272            | (2,211 )    | (1,711 )     |
| Less: Net (loss) income attributable to the non-controlling interest | 11,758                                      | (1,017 )         | (776 )      | 8            |
| Net income (loss) attributable to JMP Group Inc.                     | 3,493                                       | 3,289            | (1,435 )    | (1,719 )     |
| Net income attributable to JMP Group Inc. per common share:          |   |                  |             |              |
| Basic  | \$0.16                                      | \$ 0.14          | \$(0.06 )   | \$(0.08 )    |
| Diluted  | \$0.16                                      | \$ 0.14          | \$(0.06 )   | \$(0.08 )    |

|  | <b>JMP Group Inc.</b>                       |                  |             |              |
|--|---|------------------|-------------|--------------|
|  | <b>Selected Consolidated Financial Data</b> |                  |             |              |
|  | <b>Three Months Ended</b>                   |                  |             |              |
|  | <b>December</b>                             | <b>September</b> | <b>June</b> | <b>March</b> |
|  | <b>31,</b>                                  | <b>30, 2012</b>  | <b>30,</b>  | <b>31,</b>   |
|  | <b>2012</b>                                 |                  | <b>2012</b> | <b>2012</b>  |
| <i>(In thousands, except per share data)</i> |   |                  |             |              |

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|  |          |            |           |          |
|--|----------|------------|-----------|----------|
| Total net revenues after provision for loan losses                   | \$23,766 | \$ 18,627  | \$26,895  | \$31,634 |
| Non-interest expenses:   |          |            |           |          |
| Compensation and benefits  | 10,582   | 17,358     | 16,704    | 21,771   |
| Other expenses   | 7,036    | 6,277      | 5,984     | 5,676    |
| Total non-interest expenses  | 17,618   | 23,635     | 22,688    | 27,447   |
| Income (loss) before income tax expense                              | 6,148    | (5,008 )   | 4,207     | 4,187    |
| Income tax expense (benefit)   | 3,004    | (884 )     | (920 )    | 381      |
| Net income (loss)  | 3,144    | (4,124 )   | 5,127     | 3,806    |
| Less: Net (loss) income attributable to the non-controlling interest | (2,184 ) | (2,817 )   | 6,765     | 3,432    |
| Net income (loss) attributable to JMP Group Inc.                     | 5,328    | (1,307 )   | (1,638 )  | 374      |
| Net income attributable to JMP Group Inc. per common share:          |          |            |           |          |
| Basic  | \$0.23   | \$ (0.06 ) | \$(0.07 ) | \$0.02   |
| Diluted  | \$0.23   | \$ (0.06 ) | \$(0.07 ) | \$0.02   |

**Item 9. Changes in and Disagreements With Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures**

Our management, with the participation of the Chairman and Chief Executive Officer and the Chief Financial Officer (our principal executive officer and principal financial officer, respectively), has evaluated our disclosure controls and procedures as of the end of the year covered by this Annual Report on Form 10-K.

Based on that evaluation, our Chairman and Chief Executive Officer and Chief Financial Officer have concluded that, based on the criteria established in Internal Control- Integrated Framework issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission, as of the end of the year covered by this report, our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including the Chairman and Chief Executive Officer and the Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

There was no change in our internal control over financial reporting that occurred during the three months ended December 31, 2013 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our management report on internal control over financial reporting is contained in Part II, Item 8 of this Annual Report on Form 10-K and is incorporated herein by reference.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of the inherent limitations of any system of internal control. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses of judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper overriding of controls. As a result of such limitations, there is risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

**Item 9B. Other Information**

None.

## **PART III**

### **Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this item will be contained in the sections of our Proxy Statement for the 2014 Annual Meeting of Stockholders, captioned “Board of Directors,” “Compensation of Directors,” and “Section 16(a) Beneficial Ownership Reporting Compliance,” which is incorporated herein by reference.

### **Item 11. Executive Compensation**

Information with respect to this item will be contained in the sections of our Proxy Statement for the 2014 Annual Meeting of Stockholders, captioned “Executive Compensation” which is incorporated herein by reference.

### **Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Information with respect to this item will be contained in the sections of our Proxy Statement for the 2014 Annual Meeting of Stockholders, captioned “Ownership of Certain Beneficial Owners and Management” and “Equity Compensation Plan Information” which is incorporated herein by reference.

### **Item 13. Certain Relationships and Related Transactions, and Director Independence**

Information with respect to this item will be contained in the sections of our Proxy Statement for the 2014 Annual Meeting of Stockholders, captioned “Related Party Transactions” and “Director Independence” which is incorporated herein by reference.

### **Item 14. Principal Accountant Fees and Services**

Information with respect to this item will be contained in the sections of our Proxy Statement for the 2014 Annual Meeting of Stockholders, captioned "Fees Paid to Independent Registered Public Accounting Firm" which is incorporated herein by reference.

## **PART IV**

### **Item 15. Exhibits and Financial Statement Schedules**

(a) Documents filed as part of this Form 10-K:

#### 1. Consolidated Financial Statements

The consolidated financial statements required to be filed in the Form 10-K are listed below. The required financial statements appear on pages \_\_ through \_\_ herein.

### **INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

Report of Independent Registered Public Accounting Firm

Consolidated Statements of Financial Condition as of December 31, 2013 and 2012

Consolidated Statements of Operations for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Comprehensive Income for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Changes in Stockholders' Equity for the years ended December 31, 2013, 2012 and 2011

Consolidated Statements of Cash Flows for the years ended December 31, 2013, 2012 and 2011

Notes to Consolidated Financial Statements

#### 2. Financial Statement Schedules

Separate financial statement schedules have been omitted either because they are not applicable or because the required information is included in the consolidated financial statements.

#### 3. Exhibits

See the Exhibit Index immediately following the signature page of this Form 10-K for a list of the exhibits being filed or furnished with or incorporated by reference into this Annual Report on Form 10-K.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: March 13, 2014

JMP GROUP INC.

By: / S / JOSEPH A. JOLSON  
**Joseph A. Jolson**  
**Chairman and Chief Executive Officer**

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Date: March 13, 2014

| <b>Signature</b>                                      | <b>Title</b>  |
|---|---|
| / S / JOSEPH A. JOLSON<br><b>Joseph A. Jolson</b>     | Director, Chairman and Chief Executive Officer<br>(principal executive officer) |
| / S / RAYMOND S. JACKSON<br><b>Raymond S. Jackson</b> | Chief Financial Officer<br>(principal financial and accounting officer)         |
| / S / CRAIG R. JOHNSON<br><b>Craig R. Johnson</b>     | Director  |
| / S / DAVID M. DIPIETRO<br><b>David M. DiPietro</b>   | Director  |



/ S / KENNETH M. KARMIN      Director  
**Kenneth M. Karmin**

/ S / MARK L. LEHMANN      Director  
**Mark L. Lehmann**

/ S / H. MARK LUNENBURG      Director  
**H. Mark Lunenburg**

/ S / JONATHAN M. ORSZAG      Director  
**Jonathan M. Orszag**

/ S / CARTER D. MACK      Director  
**Carter D. Mack**

/ S / GLENN H. TONGUE      Director  
**Glenn H. Tongue**

**EXHIBIT INDEX**

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 2.1                       | Reorganization and Exchange Agreement (incorporated by reference to Exhibit 2.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).   |
| 2.2                       | Cratos Purchase Agreement dated March 31, 2009 (incorporated by reference to Exhibit to the Registrant's quarterly report with respect to the quarter ended June 30, 2009 on Form 10-Q filed on August 6, 2009).   |
| 3.1                       | Fourth Amended and Restated Certificate of Incorporation of JMP Group Inc. (incorporated by reference to Exhibit 3.1 to the Registrant's quarterly report with respect to the quarter ended March 31, 2007 on Form 10-Q filed on June 21, 2007).   |
| 3.2                       | Amended and Restated Bylaws of JMP Group Inc. (incorporated by reference to Exhibit 3.2 to the Registrant's quarterly report with respect to the quarter ended March 31, 2007 on Form 10-Q filed on June 21, 2007).  |
| 4.1                       | Form of Certificate Representing Shares of Common Stock (incorporated by reference to Exhibit 4.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on April 19, 2007).  |
| 4.2                       | Indenture dated as of January 24, 2013, between JMP Group Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.1 to the Registrant's current report on Form 8-K filed on January 25, 2013).   |
| 4.3                       | First Supplemental Indenture dated as of January 25, 2013, between JMP Group Inc. and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 4.2 to the Registrant's current report on Form 8-K filed on January 25, 2013).  |
| 4.4                       | Form of 8.00% Senior Note due 2023 (included as Exhibit A to Exhibit 4.3 above).   |
| 4.5                       | Indenture dated as of April 30, 2013, by and among JMP Credit Advisors CLO II Ltd., as issuer, JMP Credit Advisors CLO II LLC, as co-issuer, and U.S. Bank National Association, as trustee (incorporated by reference to Exhibit 10.1 to the Registrant's current report on Form 8-K filed on May 6, 2013). |
| 10.1                      | Amendment Number Three to Credit Agreement, dated as of December 31, 2008 (incorporated by reference to Exhibit 10.1 to the Registrant's   |

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current report on Form 8-K filed on January 7, 2009).

- 10.1.1 Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.1.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).
- 10.2 Form of Partners' Exchange Agreement (incorporated by reference to Exhibit 10.2 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).
- 10.3 Credit Agreement Dated August 3, 2006 (incorporated by reference to Exhibit 10.3 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on March 27, 2007).
- 10.5 Form of Indemnification Agreement (incorporated by reference to Exhibit 10.5 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on March 27, 2007).
- 10.8 Lease Agreement, Dated December 18, 2003 (incorporated by reference to Exhibit 10.8 to the Registrant's registration statement on Form S-1 (No. 333-140689) filed on February 14, 2007).
- 10.8.1 First Amendment Letter to Lease Dated May 10, 2004 (incorporated by reference to Exhibit 10.8.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on April 19, 2007).
- 10.9 Sublease, Dated December 18, 2003 (incorporated by reference to Exhibit 10.9 to the Registrant's registration statement on Form S-1 (No. 333-140689) filed on February 14, 2007).
- 10.9.1 Consent to Sublease, Dated December 18, 2003 (incorporated by reference to Exhibit 10.9.1 to the Registrant's registration statement on Form S-1 (No. 333-140689) filed on February 14, 2007).
- 10.9.2 Letter Amendment to Consent to Sublease, Dated May 10, 2004 (incorporated by reference to Exhibit 10.9.2 to the Registrant's registration statement on Form S-1 (No. 333-140689) filed on February 14, 2007).
- 10.10 JMP Group Inc. 2007 Senior Executive Bonus Plan (incorporated by reference to Exhibit 10.10 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on April 19, 2007).
- 10.11 JMP Group LLC 2004 Equity Incentive Plan (incorporated by reference to Exhibit 10.11 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).
- 10.12 Form of Stock Pledge Agreement (incorporated by reference to Exhibit 10.12 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on May 8, 2007).



| Exhibit Number | Description   |
|----------------|---|
| 10.13          | JMP Group 2007 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed on April 19, 2007).   |
| 10.13.1        | Notice of Restricted Stock Unit Agreement (Principal Portion of Award) (incorporated by reference to Exhibit 10.13.1 to the Registrant's quarterly report with respect to the quarter ended March 31, 2008 on Form 10-Q filed May 9, 2008). |
| 10.13.2        | Notice of Restricted Stock Unit Agreement (Discount Portion of Award) (incorporated by reference to Exhibit 10.13.2 to the Registrant's quarterly report with respect to the quarter ended March 31, 2008 on Form 10-Q filed May 9, 2008).  |
| 10.13.3        | Notice of Restricted Stock Unit Agreement (Four-Year Cliff) (incorporated by reference to Exhibit 10.13.3 to the Registrant's quarterly report with respect to the quarter ended March 31, 2008 on Form 10-Q filed May 9, 2008).            |
| 10.13.4        | Form of 2008 Compensation Program Election Form and Participation Agreement (incorporated by reference to Exhibit 10.13.4 to the Registrant's Current Report on Form 8-K filed February 5, 2009).   |
| 10.13.5        | Form of Restricted Stock Bonus Award Agreement (incorporated by reference to Exhibit 10.13.4 to the Registrant's Current Report on Form 8-K filed February 5, 2009).  |
| 10.15          | Amendment Number Two to Credit Agreement (CNB) (incorporated by reference to Exhibit 10.15 to the Registrant's quarterly report with respect to the quarter ended March 31, 2008 on Form 10-Q filed May 9, 2008).                           |
| 10.16          | Amendment Number One to Credit Agreement (CNB) (incorporated by reference to Exhibit 10.16 to the Registrant's annual report on Form 10-K filed on March 9, 2010).  |
| 10.17          | Summary of Compensation Arrangements with Executive Officers, Dated March 3, 2009 (incorporated by reference to Exhibit 10.1 to the Registrant's quarterly report on Form 10-Q filed on May 8, 2009).                                       |
| 10.18          | Summary of Performance Goals under the 2007 Senior Executive Bonus Plan (incorporated by reference to Exhibit 10.1 to the Registrant's quarterly report on Form 10-Q filed on August 10, 2007).   |
| 10.19          | Form of Tax Identification Agreement (incorporated by reference to Exhibit 10.7 to the Registrant's registration statement on Form S-1/A (No. 333-140689) filed May 8, 2007).   |
| 10.20          | Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.13.6 to the Registrant's quarterly report on Form 10-Q filed on May 6, 2010).  |
| 10.20.1        | Amendment Number Four to Credit Agreement, Dated January 28, 2010 (incorporated by reference to Exhibit 10.17 to the Registrant's quarterly report on Form 10-Q filed on May 6, 2010).  |
| 10.20.2        | Amendment Number Five to Credit Agreement, dated as of April 8, 2011 (incorporated by reference to Exhibit 10.20.2 to the Registrant's quarterly report on Form 10-Q filed on August 4, 2011).  |

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- 10.20.3 Amendment Number Six to Credit Agreement, dated as of August 24, 2011 (incorporated by reference to the Registrant's current report on Form 8-K filed on August 25, 2011).
- 10.20.4 Amended and Restated Credit Agreement, dated October 11, 2012 (incorporated by reference to Exhibit 10.20.4 to the Registrant's quarterly report on Form 10-Q filed on November 1, 2012).
- 10.20.5 Amendment Number Two to Revolving Note and Cash Subordination Agreement & Revolving Note, dated October 11, 2012 (incorporated by reference to Exhibit 10.20.5 to the Registrant's quarterly report on Form 10-Q filed on November 1, 2012).
- 10.21 Amended Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.21 to the Registrant's quarterly report on Form 10-Q filed on August 2, 2012).
- 10.20.6 Amendment Number One to Amended and Restated Credit Agreement, dated as of April 8, 2013 (incorporated by reference to Exhibit 10.20.6 to the Registrant's quarterly report on Form 10-Q filed on May 6, 2013).
- 10.23 Portfolio Management Agreement, dated as of April 30, 2013 between, JMP Credit Advisors CLO II Ltd., as Issuer and JMP Credit Advisors LLC, as manager (incorporated by reference to Exhibit 10.2 to the Registrant's current report on Form 8-K filed on May 6, 2013).
- 10.24 Collateral Administration Agreement, dated as of April 30, 2013, by and among JMP Credit Advisors CLO II Ltd., JMP Credit Advisors LLC and U.S. Bank National Association, as collateral administrator (incorporated by reference to Exhibit 10.3 to the Registrant's current report on Form 8-K filed on May 6, 2013).

| Exhibit Number | Description  |
|----------------|--|
| 10.25          | Purchaser Subscription Letter for Certificated Notes, dated April 25, 2013 (incorporated by reference to Exhibit 10.4 to the Registrant's current report on Form 8-K filed on May 6, 2013).  |
| 10.26*         | Credit Agreement, dated as of December 11, 2013.   |
| 21*            | List of subsidiaries of JMP Group Inc.   |
| 23.1*          | Consent of Pricewaterhouse Coopers LLP   |
| 31.1*          | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2*          | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1*          | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2*          | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101*           | The following materials from the Registrant's Annual Report on Form 10-K for the year ended December 31, 2013, formatted in Extensible Business Reporting Language (XBRL), include: (i) the Consolidated Statements of Income, (ii) the Consolidated Balance Sheets, (iii) the Consolidated Statements of Stockholders' Equity, (iv) the Consolidated Statements of Cash Flows, and (v) related notes. |

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\*Filed herewith