

STATEMENT OF FINANCIAL CONDITION

Piper Jaffray & Co.

(A Wholly Owned Subsidiary of Piper Jaffray Companies)

SEC File Number: 8-1-5204

As of December 31, 2018

With Report of Independent Registered Public Accounting Firm

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Report of Independent Registered Public Accounting Firm

To the Shareholder and the Board of Directors of Piper Jaffray & Co.

Opinion on the Financial Statement

We have audited the accompanying statement of financial condition of Piper Jaffray & Co. (the Company) as of December 31, 2018, and the related notes (collectively referred to as the “financial statement”). In our opinion, the financial statement presents fairly, in all material respects, the financial position of the Company at December 31, 2018, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

This financial statement is the responsibility of the Company’s management. Our responsibility is to express an opinion on the Company’s financial statement based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the financial statement, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statement. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Ernst + Young LLP

We have served as the Company’s auditor since 2003.

Minneapolis, Minnesota
February 26, 2019

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(Amounts in thousands, except share data)

Assets

Cash and cash equivalents	\$ 22,180
Receivables from brokers, dealers and clearing organizations	233,915
Financial instruments and other inventory positions owned	462,762
Financial instruments and other inventory positions owned and pledged as collateral	147,427
Total financial instruments and other inventory positions owned	<u>610,189</u>
Fixed assets (net of accumulated depreciation and amortization of \$54,995)	31,331
Goodwill	80,486
Intangible assets (net of accumulated amortization of \$34,034)	4,151
Investments	13,258
Net deferred income tax assets	76,862
Other assets	37,106
Total assets	<u>\$ 1,109,478</u>

Liabilities and Shareholder's Equity

Short-term financing	\$ 49,953
Payables to brokers, dealers and clearing organizations	8,657
Financial instruments and other inventory positions sold, but not yet purchased	172,884
Accrued compensation	268,616
Intercompany payable to Parent Company	66,206
Other liabilities and accrued expenses	37,044
Total liabilities	<u>603,360</u>
Shareholder's equity:	
Preferred stock, \$0.01 par value; 3,000 shares authorized, none issued and outstanding	—
Common stock, \$0.01 par value; 1,000 shares authorized, 459 issued and outstanding	—
Additional paid-in capital	484,569
Retained earnings	21,549
Total shareholder's equity	<u>506,118</u>
Total liabilities and shareholder's equity	<u>\$ 1,109,478</u>

See Notes to the Statement of Financial Condition

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Note 1 *Organization and Basis of Presentation*

Organization

Piper Jaffray & Co. ("Piper Jaffray" or the "Company") is a wholly owned subsidiary of Piper Jaffray Companies ("Parent Company"). The Parent Company is a public holding company incorporated in Delaware and traded on the New York Stock Exchange ("NYSE"). The Company is a securities broker dealer and investment banking firm registered under the Securities Exchange Act of 1934 and is a member of the Financial Industry Regulatory Authority, Inc. ("FINRA"). As such, the Company trades and effects transactions in listed and unlisted equity and fixed income securities, underwrites equity and municipal debt offerings and provides various other financial advisory services.

Pershing LLC ("Pershing") is Piper Jaffray's clearing broker dealer responsible for the clearance and settlement of firm and customer cash and security transactions.

Basis of Presentation

The accompanying statement of financial condition has been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP").

The preparation of the statement of financial condition and related disclosures in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the statement of financial condition. Although these estimates and assumptions are based on the best information available, actual results could differ from those estimates.

Note 2 *Summary of Significant Accounting Policies*

Principles of Consolidation

The Company consolidates entities in which it has a controlling financial interest. The Company determines whether it has a controlling financial interest in an entity by first evaluating whether the entity is a variable interest entity ("VIE") or a voting interest entity.

VIEs are entities in which (i) the total equity investment at risk is not sufficient to enable the entity to finance its activities independently or (ii) the at-risk equity holders do not have the normal characteristics of a controlling financial interest. A controlling financial interest in a VIE is present when an enterprise has one or more variable interests that have both (i) the power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (ii) the obligation to absorb losses of the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE. The enterprise with a controlling financial interest is the primary beneficiary and consolidates the VIE.

Voting interest entities lack one or more of the characteristics of a VIE. The usual condition for a controlling financial interest is ownership of a majority voting interest for a corporation or a majority of kick-out or participating rights for a limited partnership.

When the Company does not have a controlling financial interest in an entity but exerts significant influence over the entity's operating and financial policies, the Company's investment is accounted for under the equity method of accounting. If the Company does not have a controlling financial interest in, or exert significant influence over, an entity, the Company accounts for its investment at fair value, if the fair value option was elected, or at cost.

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Cash and Cash Equivalents

Cash and cash equivalents consist of cash and highly liquid investments with maturities of 90 days or less at the date of origination.

Fair Value of Financial Instruments

Financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased on the statement of financial condition consist of financial instruments (including securities with extended settlements and derivative contracts) recorded at fair value. Securities (both long and short), including securities with extended settlements, are recognized on a trade-date basis. Additionally, certain of the Company's investments on the statement of financial condition are recorded at fair value, either as required by accounting guidance or through the fair value election.

Fair Value Measurement – Definition and Hierarchy – Financial Accounting Standards Board ("FASB") Accounting Standards Codification Topic 820, "Fair Value Measurement," ("ASC 820") defines fair value as the amount at which an instrument could be exchanged in an orderly transaction between market participants at the measurement date (the exit price). ASC 820 establishes a fair value hierarchy based on the inputs used to measure fair value. The fair value hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability based on market data obtained from independent sources. Unobservable inputs reflect management's assumptions that market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the observability of inputs as follows:

Level I – Quoted prices (unadjusted) are available in active markets for identical assets or liabilities as of the report date. A quoted price for an identical asset or liability in an active market provides the most reliable fair value measurement because it is directly observable to the market.

Level II – Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the report date. The nature of these financial instruments include instruments for which quoted prices are available but traded less frequently, instruments whose fair value have been derived using a model where inputs to the model are directly observable in the market, or can be derived principally from or corroborated by observable market data, and instruments that are fair valued using other financial instruments, the parameters of which can be directly observed.

Level III – Instruments that have little to no pricing observability as of the report date. These financial instruments are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

Valuation of Financial Instruments – Based on the nature of the Company's business and its role as a "dealer" in the securities industry, the fair values of its financial instruments are determined internally. When available, the Company values financial instruments at observable market prices, observable market parameters, or broker or dealer prices (bid and ask prices). In the case of financial instruments transacted on recognized exchanges, the observable market prices represent quotations for completed transactions from the exchange on which the financial instrument is principally traded.

A substantial percentage of the fair value of the Company's financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased, are based on observable market prices, observable market parameters, or derived from broker or dealer prices. The availability of observable market prices and pricing parameters can vary from product to product. Where available, observable market prices and pricing or market parameters in a product may be used to derive a price without requiring significant judgment. In certain markets, observable market prices or market parameters are not available for all products, and fair value is determined

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using techniques appropriate for each particular product. These techniques involve some degree of judgment. Results from valuation models and other techniques in one period may not be indicative of future period fair value measurement.

For investments in illiquid or privately held securities that do not have readily determinable fair values, the determination of fair value requires the Company to estimate the value of the securities using the best information available. Among the factors considered by the Company in determining the fair value of such financial instruments are the cost, terms and liquidity of the investment, the financial condition and operating results of the issuer, the quoted market price of publicly traded securities with similar quality and yield, and other factors generally pertinent to the valuation of investments. In instances where a security is subject to transfer restrictions, the value of the security is based primarily on the quoted price of a similar security without restriction but may be reduced by an amount estimated to reflect such restrictions. In addition, even where the Company derives the value of a security based on information from an independent source, certain assumptions may be required to determine the security's fair value. For instance, the Company assumes that the size of positions in securities that the Company holds would not be large enough to affect the quoted price of the securities if the firm sells them, and that any such sale would happen in an orderly manner. The actual value realized upon disposition could be different from the currently estimated fair value.

Fixed Assets

Fixed assets include furniture and equipment, software and leasehold improvements. Furniture and equipment and software are depreciated using the straight-line method over estimated useful lives of three to ten years. Leasehold improvements are amortized over ten years or the life of the lease, whichever is shorter.

Leases

The Company leases its corporate headquarters and other offices under various non-cancelable leases. The leases require payment of real estate taxes, insurance and common area maintenance, in addition to rent. The terms of the Company's lease agreements generally range up to twelve years. Some of the leases contain renewal options, escalation clauses, rent-free holidays and operating cost adjustments.

For leases that contain escalation clauses or rent-free holidays, the Company recognizes the related rent expense on a straight-line basis from the date the Company takes possession of the property to the end of the initial lease term. The Company records any difference between the straight-line rent amounts and amounts payable under the leases as part of other liabilities and accrued expenses.

Cash or lease incentives received upon entering into certain leases are recognized on a straight-line basis as a reduction of rent expense from the date the Company takes possession of the property or receives the cash to the end of the initial lease term. The Company records the unamortized portion of lease incentives as part of other liabilities and accrued expenses.

Goodwill and Intangible Assets

Goodwill represents the fair value of the consideration transferred in excess of the fair value of identifiable net assets at the acquisition date. The recoverability of goodwill is evaluated annually, at a minimum, or on an interim basis if circumstances indicate a possible inability to realize the carrying amount. See Note 10 for additional information on the Company's goodwill impairment testing.

Intangible assets with determinable lives consist of customer relationships and the Simmons & Company International ("Simmons") trade name that are amortized over their original estimated useful lives ranging from four to seven years. The pattern of amortization reflects the timing of the realization of the economic benefits of such intangible assets.

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Investments

The Company's investments include equity investments in private companies and partnerships and investments in registered mutual funds. Equity investments in private companies are accounted for at fair value, as required by accounting guidance or if the fair value option was elected. Investments in partnerships are accounted for under the equity method, which is generally the net asset value. Investments in registered mutual funds are accounted for at fair value.

Other Assets

Other assets include receivables and prepaid expenses. Receivables include fee receivables, accrued interest, and loans made to employees, typically in connection with their recruitment. Employee loans are forgiven based on continued employment and are amortized using the straight-line method over the respective terms of the loans, which generally range from two to five years.

Income Taxes

The Company is included in the consolidated U.S. federal income tax return filed by the Parent Company on a calendar year basis, combined returns for state tax purposes where required and separate state income tax returns where required. The Company determines and records income taxes based upon the provisions of a tax sharing arrangement with the Parent Company and U.S. affiliated entities. Deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to temporary differences between amounts reported for income tax purposes and financial statement purposes, using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The realization of deferred tax assets is assessed and a valuation allowance is recognized to the extent that it is more likely than not that any portion of a deferred tax asset will not be realized. Tax reserves for uncertain tax positions are recorded in accordance with FASB Accounting Standards Codification Topic 740, "Income Taxes" ("ASC 740"). The Company recognizes interest and penalties, if any, related to income tax matters as part of the provision for income taxes.

Contingencies

The Company is involved in various pending and potential legal proceedings related to its business, including litigation, arbitration and regulatory proceedings. The Company establishes reserves for potential losses to the extent that claims are probable of loss and the amount of the loss can be reasonably estimated. The determination of the outcome and reserve amounts requires significant judgment on the part of the Company's management.

Note 3 Recent Accounting Pronouncements

Adoption of New Accounting Standards

Revenue Recognition

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"), which supersedes previous revenue recognition guidance, including most industry-specific guidance. ASU 2014-09, as amended, requires a company to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods and services, and also requires enhanced disclosures.

The Company adopted this guidance effective as of January 1, 2018 under the modified retrospective method, in which the cumulative effect of applying the standard was recognized at the date of initial application. The cumulative effect adjustment that the Company recognized upon adoption as of January 1, 2018 was a decrease to retained earnings of \$3.2 million, net of tax. The Company applied the guidance only to those contracts that were not completed at the date of initial application.

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Recognition and Measurement of Financial Assets and Financial Liabilities

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" ("ASU 2016-01"). The amendments in ASU 2016-01 address certain aspects of the recognition, measurement, presentation and disclosure of financial instruments. ASU 2016-01 became effective for the Company as of January 1, 2018. There was no material impact to the Company's financial position or disclosures upon adoption as the Company's financial instruments were already recorded at fair value.

Future Adoption of New Applicable Accounting Standards

Leases

In February 2016, the FASB issued ASU No. 2016-02, "Leases (Topic 842)" ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize a right-of-use asset and lease liability on the statement of financial position for all leases with a term longer than 12 months and disclose key information about leasing arrangements. The Company will adopt ASU 2016-02 as of January 1, 2019 using the modified retrospective approach.

Upon adoption, the Company estimates that it will recognize a right-of-use asset of approximately \$40.2 million and a lease liability of approximately \$54.7 million. The difference between the right-of-use asset and the lease liability is due to lease incentives. The new guidance is not expected to impact Piper Jaffray's net capital position. The Company continues to evaluate the new disclosure requirements of ASU 2016-02.

Financial Instruments – Credit Losses

In June 2016, the FASB issued ASU No. 2016-13, "Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" ("ASU 2016-13"). The new guidance requires an entity to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts as opposed to delaying recognition until the loss was probable of occurring. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019. The Company does not expect the adoption of ASU 2016-13 to have a material impact on its statement of financial condition.

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Note 4 *Financial Instruments and Other Inventory Positions Owned and Financial Instruments and Other Inventory Positions Sold, but Not Yet Purchased*

<i>(Dollars in thousands)</i>	December 31, 2018
Financial instruments and other inventory positions owned:	
Corporate securities:	
Equity securities	\$ 1,458
Convertible securities	92,485
Fixed income securities	31,906
Municipal securities:	
Taxable securities	38,711
Tax-exempt securities	268,804
Short-term securities	52,472
Mortgage-backed securities	15
U.S. government agency securities	123,384
U.S. government securities	954
	\$ 610,189
Financial instruments and other inventory positions sold, but not yet purchased:	
Corporate securities:	
Equity securities	\$ 82,082
Fixed income securities	20,180
U.S. government agency securities	10,257
U.S. government securities	60,365
	\$ 172,884

At December 31, 2018, financial instruments and other inventory positions owned in the amount of \$147.4 million had been pledged as collateral for short-term financings.

Financial instruments and other inventory positions sold, but not yet purchased represent obligations of the Company to deliver the specified security at the contracted price, thereby creating a liability to purchase the security in the market at prevailing prices. The Company is obligated to acquire the securities sold short at prevailing market prices, which may exceed the amount reflected on the statement of financial condition. The Company economically hedges changes in the market value of its financial instruments and other inventory positions owned using inventory positions sold, but not yet purchased.

Note 5 *Fair Value of Financial Instruments*

Based on the nature of the Company's business and its role as a "dealer" in the securities industry, the fair values of its financial instruments are determined internally. The Company's processes are designed to ensure that the fair values used for financial reporting are based on observable inputs wherever possible. In the event that observable inputs are not available, unobservable inputs are developed based on an evaluation of all relevant empirical market data, including prices evidenced by market transactions, interest rates, credit spreads, volatilities and correlations and other security-specific information. Valuation adjustments related to illiquidity or counterparty credit risk are also considered. In estimating fair value, the Company may utilize information provided by third party pricing vendors to corroborate internally-developed fair value estimates.

The Company employs specific control processes to determine the reasonableness of the fair value of its financial instruments. The Company's processes are designed to ensure that the internally-estimated fair values are accurately recorded and that the data inputs and the valuation techniques used are appropriate, consistently applied, and that the assumptions are reasonable and consistent with the objective of determining fair value. Individuals outside of the trading

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departments perform independent pricing verification reviews as of each reporting date. The Company has established parameters which set forth when the fair value of securities are independently verified. The selection parameters are generally based upon the type of security, the level of estimation risk of a security, the materiality of the security to the Company's statement of financial condition, changes in fair value from period to period, and other specific facts and circumstances of the Company's securities portfolio. In evaluating the initial internally-estimated fair values made by the Company's traders, the nature and complexity of securities involved (e.g., term, coupon, collateral, and other key drivers of value), level of market activity for securities, and availability of market data are considered. The independent price verification procedures include, but are not limited to, analysis of trade data (both internal and external where available), corroboration to the valuation of positions with similar characteristics, risks and components, or comparison to an alternative pricing source, such as a discounted cash flow model. The Company's valuation committee, comprised of members of senior management and risk management, provides oversight and overall responsibility for the internal control processes and procedures related to fair value measurements.

The following is a description of the valuation techniques used to measure fair value.

Cash Equivalents

Cash equivalents include highly liquid investments with original maturities of 90 days or less. Actively traded money market funds are measured at their net asset value and classified as Level I.

Financial Instruments and Other Inventory Positions Owned

The Company records financial instruments and other inventory positions owned and financial instruments and other inventory positions sold, but not yet purchased at fair value on the statement of financial condition.

Equity securities – Exchange traded equity securities are valued based on quoted prices from the exchange for identical assets or liabilities as of the period-end date. To the extent these securities are actively traded and valuation adjustments are not applied, they are categorized as Level I. Non-exchange traded equity securities (principally hybrid preferred securities) are measured primarily using broker quotations, prices observed for recently executed market transactions and internally-developed fair value estimates based on observable inputs and are categorized within Level II of the fair value hierarchy.

Convertible securities – Convertible securities are valued based on observable trades, when available. Accordingly, these convertible securities are categorized as Level II.

Corporate fixed income securities – Fixed income securities include corporate bonds which are valued based on recently executed market transactions of comparable size, internally-developed fair value estimates based on observable inputs, or broker quotations. Accordingly, these corporate bonds are categorized as Level II.

Taxable municipal securities – Taxable municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II.

Tax-exempt municipal securities – Tax-exempt municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II.

Short-term municipal securities – Short-term municipal securities include auction rate securities, variable rate demand notes, and other short-term municipal securities. Variable rate demand notes and other short-term municipal securities are valued using recently executed observable trades or market price quotations and therefore are generally categorized as Level II.

Mortgage-backed securities – Certain mortgage-backed securities collateralized by residential mortgages are valued using cash flow models that utilize unobservable inputs including credit default rates, prepayment rates, loss severity

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and valuation yields. As judgment is used to determine the range of these inputs, these mortgage-backed securities are categorized as Level III.

U.S. government agency securities – U.S. government agency securities include agency debt bonds and mortgage bonds. Agency debt bonds are valued by using either direct price quotes or price quotes for comparable bond securities and are categorized as Level II. Mortgage bonds include bonds secured by mortgages, mortgage pass-through securities, agency collateralized mortgage-obligation ("CMO") securities and agency interest-only securities. Mortgage pass-through securities, CMO securities and interest-only securities are valued using recently executed observable trades or other observable inputs, such as prepayment speeds and therefore are generally categorized as Level II. Mortgage bonds are valued using observable market inputs, such as market yields on spreads over U.S. treasury securities, or models based upon prepayment expectations. These securities are categorized as Level II.

U.S. government securities – U.S. government securities include highly liquid U.S. treasury securities which are generally valued using quoted market prices and therefore categorized as Level I. The Company does not transact in securities of countries other than the U.S. government.

Investments

The Company's investments valued at fair value include equity investments in private companies and partnerships and investments in registered mutual funds. Investments in registered mutual funds are valued based on quoted prices on active markets and classified as Level I. Investments in private companies are valued based on an assessment of each underlying security. These securities are generally categorized as Level II or Level III based on observability of inputs.

Fair Value Option – The fair value option permits the irrevocable fair value option election on an instrument-by-instrument basis at initial recognition of an asset or liability or upon an event that gives rise to a new basis of accounting for that instrument. The fair value option was elected for certain equity investments at inception to reflect economic events in earnings on a timely basis. Equity investments of \$0.3 million, included within investments on the statement of financial condition, are accounted for at fair value and are classified as Level III assets at December 31, 2018.

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The following table summarizes the valuation of the Company's financial instruments by pricing observability levels defined in ASC 820 as of December 31, 2018:

<i>(Dollars in thousands)</i>	<u>Level I</u>	<u>Level II</u>	<u>Level III</u>	<u>Total</u>
Assets:				
Financial instruments and other inventory positions owned:				
Corporate securities:				
Equity securities	\$ 331	\$ 1,127	\$ —	\$ 1,458
Convertible securities	—	92,485	—	92,485
Fixed income securities	—	31,906	—	31,906
Municipal securities:				
Taxable securities	—	38,711	—	38,711
Tax-exempt securities	—	268,804	—	268,804
Short-term securities	—	52,472	—	52,472
Mortgage-backed securities	—	—	15	15
U.S. government agency securities	—	123,384	—	123,384
U.S. government securities	954	—	—	954
Total financial instruments and other inventory positions owned	<u>1,285</u>	<u>608,889</u>	<u>15</u>	<u>610,189</u>
Cash equivalents	18,000	—	—	18,000
Investments at fair value	2,368	2,649	1,213	6,230
Total assets	<u>\$ 21,653</u>	<u>\$ 611,538</u>	<u>\$ 1,228</u>	<u>\$ 634,419</u>
Liabilities:				
Financial instruments and other inventory positions sold, but not yet purchased:				
Corporate securities:				
Equity securities	\$ 81,575	\$ 507	\$ —	\$ 82,082
Fixed income securities	—	20,180	—	20,180
U.S. government agency securities	—	10,257	—	10,257
U.S. government securities	60,365	—	—	60,365
Total financial instruments and other inventory positions sold, but not yet purchased	<u>\$ 141,940</u>	<u>\$ 30,944</u>	<u>\$ —</u>	<u>\$ 172,884</u>

The Company's Level III assets were \$1.2 million, or 0.2 percent of financial instruments measured at fair value at December 31, 2018.

The carrying values of the Company's cash, receivables and payables either from or to brokers, dealers and clearing organizations and short-term financings approximate fair value due to their liquid or short-term nature.

Note 6 Variable Interest Entities

The Company has investments in various partnerships, limited liability companies, or registered mutual funds. These entities were established for the purpose of investing in securities of public or private companies, or municipal debt obligations, or providing financing to senior living facilities, and were initially financed through the capital commitments or seed investments of the members.

VIEs are entities in which equity investors lack the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities. The determination as to whether an entity is a VIE is based on the structure and nature of each entity. The Company also considers other characteristics such as the power through voting rights or similar rights to direct the activities of an entity that most significantly impact the entity's economic performance and how the entity is financed.

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The Company is required to consolidate all VIEs for which it is considered to be the primary beneficiary. The determination as to whether the Company is considered to be the primary beneficiary is based on whether the Company has both the power to direct the activities of the VIE that most significantly impact the entity's economic performance and the obligation to absorb losses or the right to receive benefits of the VIE that could potentially be significant to the VIE.

The Company determined it is not the primary beneficiary of these VIEs and accordingly does not consolidate them. These VIEs had net assets approximating \$0.1 billion at December 31, 2018. The Company's exposure to loss from these VIEs is \$4.5 million, which is the carrying value of its capital contributions recorded in investments on the statement of financial condition at December 31, 2018. The Company had no liabilities related to these VIEs at December 31, 2018. Furthermore, the Company has not provided financial or other support to these VIEs that it was not previously contractually required to provide as of December 31, 2018.

Note 7 Receivables from and Payables to Brokers, Dealers and Clearing Organizations

	December 31, 2018
<i>(Dollars in thousands)</i>	
Receivable from clearing organizations	\$ 223,987
Deposits with clearing organizations	230
Receivable from brokers and dealers	7,700
Other	1,998
Total receivables from brokers, dealers and clearing organizations	<u>\$ 233,915</u>

	December 31, 2018
<i>(Dollars in thousands)</i>	
Payable to clearing organizations	\$ 4,734
Payable to brokers and dealers	3,923
Total payables to brokers, dealers and clearing organizations	<u>\$ 8,657</u>

As discussed in Note 1, Piper Jaffray transitioned from a self clearing securities broker dealer to a fully disclosed clearing model in 2017. Under the Company's fully disclosed clearing agreement, the majority of its securities inventories and all of its customer activities are held by or cleared through Pershing. The Company has also established an arrangement to obtain financing from Pershing related to the majority of its trading activities. Financing under this arrangement is secured primarily by securities, and collateral limitations could reduce the amount of funding available under this arrangement. The funding is at the discretion of Pershing and could be denied. The Company's clearing arrangement activities are recorded net from trading activity. The Company's fully disclosed clearing agreement includes a covenant requiring Piper Jaffray to maintain excess net capital of \$120 million.

Note 8 Investments

The Company's investments include investments in private companies and partnerships and registered mutual funds.

	December 31, 2018
<i>(Dollars in thousands)</i>	
Investments at fair value	\$ 6,230
Investments at cost	1,512
Investments accounted for under the equity method	5,516
Total investments	<u>\$ 13,258</u>

At December 31, 2018, investments carried on a cost basis had an estimated fair market value of \$1.5 million. Because valuation estimates were based upon management's judgment, investments carried at cost would be categorized as Level III assets in the fair value hierarchy, if they were carried at fair value.

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Investments accounted for under the equity method include limited partnership interests. The carrying value of these investments is based on the investment vehicle's net asset value. The net assets of investment partnerships consist of investments in both marketable and non-marketable securities. The underlying investments held by such partnerships are valued based on the estimated fair value determined by management of our affiliated partnerships and, in the case of investments in unaffiliated investment partnerships, are based on financial statements prepared by the unaffiliated general partners.

Note 9 Other Assets

<i>(Dollars in thousands)</i>	December 31, 2018
Fee receivables	\$ 17,218
Accrued interest receivables	4,006
Forgivable loans, net	6,750
Prepaid expenses	7,672
Other	1,460
Total other assets	<u>\$ 37,106</u>

Note 10 Goodwill and Intangible Assets

<i>(Dollars in thousands)</i>	
Goodwill	
Balance at December 31, 2017	\$ 80,486
Goodwill acquired	—
Balance at December 31, 2018	<u>\$ 80,486</u>
Intangible assets	
Balance at December 31, 2017	\$ 8,904
Intangible assets acquired	—
Amortization of intangible assets	(4,753)
Balance at December 31, 2018	<u>\$ 4,151</u>

The Company tests goodwill and indefinite-life intangible assets for impairment on an annual basis and on an interim basis when circumstances exist that could indicate possible impairment. The Company tests for impairment at the reporting unit level, which is generally one level below its operating segments. The Company has identified one reporting unit: capital markets. When testing for impairment, the Company has the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of the reporting unit is less than its carrying amount. If, after making an assessment, the Company determines it is not more likely than not that the fair value of the reporting unit is less than its carrying amount, then further analysis is unnecessary. However, if the Company concludes otherwise, then the Company is required to perform a quantitative goodwill test, which requires management to make judgments in determining what assumptions to use in the calculation. The quantitative goodwill test compares the fair value of the reporting unit to its carrying value, including allocated goodwill. An impairment is recognized for the excess amount of a reporting unit's carrying value over its fair value. The estimated fair value of the reporting unit is derived based on valuation techniques that a market participant would use. The Company estimates the fair value of the reporting unit using the income approach (discounted cash flow method) and market approach (earnings and/or transaction multiples).

The Company performed its annual goodwill impairment testing as of October 31, 2018, which resulted in no impairment. The Company also evaluated its definite-lived intangible assets and concluded there was no impairment in 2018.

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Note 11 *Fixed Assets*

	December 31, 2018
<i>(Dollars in thousands)</i>	
Furniture and equipment	\$ 41,949
Leasehold improvements	32,950
Software	11,427
Total	86,326
Accumulated depreciation and amortization	(54,995)
	\$ 31,331

Note 12 *Short-Term Financing*

The Company issues secured commercial paper to fund a portion of its securities inventory. The commercial paper notes ("CP Notes") can be issued with maturities of 27 days to 270 days from the date of issuance. The CP Notes are currently issued under two separate programs, CP Series A and CP Series II A, and are secured by different inventory classes. As of December 31, 2018, the weighted average maturity of outstanding CP Notes was 10 days. The CP Notes are interest bearing or sold at a discount to par with an interest rate based on LIBOR plus an applicable margin. CP Series II A includes a covenant that the Company to maintain excess net capital of \$100 million. At December 31, 2018, the Company had CP Notes of \$50.0 million outstanding with a weighted average interest rate of 3.38%.

The Company has both committed and uncommitted short-term bank line financing available on a secured basis. The Company uses these credit facilities in the ordinary course of business to fund a portion of its daily operations and the amount borrowed under these credit facilities varies daily based on the Company's funding needs.

The Company's committed short-term bank line financing at December 31, 2018 consisted of a one-year \$175 million committed revolving credit facility with U.S. Bank, N.A., which was renewed in December 2018. Advances under this facility are secured by certain marketable securities. The facility includes a covenant that requires the Company to maintain minimum net capital of \$120 million, and the unpaid principal amount of all advances under this facility will be due on December 13, 2019. The Company pays a nonrefundable commitment fee on the unused portion of the facility on a quarterly basis. At December 31, 2018, the Company had no advances against this line of credit.

The Company's uncommitted secured line at December 31, 2018 was \$85 million and is dependent on having appropriate collateral, as determined by the bank agreement, to secure an advance under the line. The availability of the Company's uncommitted line is subject to approval by the bank each time an advance is requested and may be denied. At December 31, 2018, the Company had no advances against this line of credit.

Note 13 *Contingencies, Commitments and Guarantees*

Legal Contingencies

The Company has been named as a defendant in various legal actions, including complaints and litigation and arbitration claims, arising from its business activities. Such actions include claims related to securities brokerage and investment banking activities, and certain class actions that primarily allege violations of securities laws and seek unspecified damages, which could be substantial. Also, the Company is involved from time to time in investigations and proceedings by governmental agencies and self-regulatory organizations ("SROs") which could result in adverse judgments, settlement, penalties, fines or other relief.

Given uncertainties regarding the timing, scope, volume and outcome of pending and potential legal actions, investigations and regulatory proceedings and other factors, the amounts of reserves and ranges of reasonably possible losses are difficult to determine and of necessity subject to future revision. Subject to the foregoing, management of the Company believes, based on currently available information, after consultation with outside legal counsel and taking

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into account its established reserves, that pending legal actions, investigations and regulatory proceedings will be resolved with no material adverse effect on the statement of financial condition of the Company. However, if during any period a potential adverse contingency should become probable or resolved for an amount in excess of the established reserves, the financial condition as of the end of that period could be materially adversely affected. In addition, there can be no assurance that material losses will not be incurred from claims that have not yet been brought to the Company's attention or are not yet determined to be reasonably possible.

Operating Lease Commitments

The Company leases office space throughout the United States. Aggregate minimum lease commitments under operating leases as of December 31, 2018 are as follows:

(Dollars in thousands)

2019	\$	12,095
2020		12,175
2021		8,212
2022		7,283
2023		7,101
Thereafter		15,771
		<u>\$ 62,637</u>

Total minimum rentals to be received from 2019 through 2021 under noncancelable subleases were \$2.3 million at December 31, 2018.

Investment Commitments

As of December 31, 2018, the Company had commitments to invest approximately \$4.1 million in limited partnerships that make investments in private equity companies.

Other Guarantees

The Company is a member of numerous exchanges. Under the membership agreements with these entities, members generally are required to guarantee the performance of other members, and if a member becomes unable to satisfy its obligations to the exchange, other members would be required to meet shortfalls. To mitigate these performance risks, the exchanges often require members to post collateral. In addition, the Company identifies and guarantees certain clearing agents against specified potential losses in connection with providing services to the Company or its affiliates. The Company's maximum potential liability under these arrangements cannot be quantified. However, management believes the likelihood that the Company would be required to make payments under these arrangements is remote. Accordingly, no liability is recorded in the statement of financial condition for these arrangements.

Concentration of Credit Risk

The Company provides investment, capital-raising and related services to a diverse group of domestic and foreign customers, including governments, corporations, and institutional and individual investors. The Company's exposure to credit risk associated with the non-performance of customers in fulfilling their contractual obligations pursuant to securities transactions can be directly impacted by volatile securities markets, credit markets and regulatory changes. This exposure is measured on an individual customer basis and on a group basis for customers that share similar attributes. To alleviate the potential for risk concentrations, counterparty credit limits have been implemented for certain products and are continually monitored in light of changing customer and market conditions.

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Note 14 *Employee Benefit Plans*

The Parent Company has various employee benefit plans, and substantially all Company employees are covered by at least one plan. The plans include health and welfare plans and a tax-qualified retirement plan.

Note 15 *Parent Company Compensation Plans*

Stock-Based Compensation

The Parent Company maintains a stock-based compensation plan, the Piper Jaffray Companies Amended and Restated 2003 Annual and Long-Term Incentive Plan (the "Incentive Plan"). The Incentive Plan permits the grant of equity awards, including restricted stock, restricted stock units and non-qualified stock options, to the Company's employees. The awards granted to employees have three or five year vesting periods or cliff vest upon meeting certain performance or market-based metrics. The Incentive Plan provides for accelerated vesting of awards if there is a severance event, a change in control of the Parent Company (as defined in the Incentive Plan), in the event of a participant's death, and at the discretion of the compensation committee of the Parent Company's board of directors.

The Parent Company also established the 2016 Employment Inducement Award Plan (the "Inducement Plan") in conjunction with the acquisition of Simmons. These shares cliff vest in three years. Employees forfeit unvested Inducement Plan shares upon termination of employment.

Acquisition-related Compensation Arrangements

In addition to the Inducement Plan, the Company entered into acquisition-related compensation arrangements with certain employees for retention purposes. Additional cash compensation may be available to certain employees subject to exceeding an investment banking revenue threshold during the three year Simmons post-acquisition period to the extent they are employed by the Company at the time of payment. Amounts estimated to be payable related to this performance award plan will be recorded over the requisite performance period of three years. As of December 31, 2018, the Company had accrued \$34.6 million related to this performance award plan.

Deferred Compensation Plans

The Parent Company maintains various deferred compensation arrangements for employees.

The Piper Jaffray Companies Mutual Fund Restricted Share Investment Plan is a fully funded deferred compensation plan which allows eligible employees to receive a portion of their incentive compensation in restricted mutual fund shares ("MFRS Awards") of investment funds. MFRS Awards vest ratably over three years in equal installments and provide for continued vesting after termination of employment so long as the employee does not violate certain post-termination restrictions set forth in the award agreement or any agreement entered into upon termination. MFRS Awards are owned by employee recipients (subject to the aforementioned vesting restrictions) and as such are not included on the statement of financial condition.

The nonqualified deferred compensation plan is an unfunded plan which allows certain highly compensated employees, at their election, to defer a percentage of their compensation. In 2017, this plan was closed to future deferral elections by participants for performance periods beginning after December 31, 2017. The amounts deferred under this plan are held in a grantor trust. The Parent Company invests, as a principal, in investments to economically hedge its obligation under the nonqualified deferred compensation plan.

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Note 16 *Net Capital Requirements and Other Regulatory Matters*

Piper Jaffray is registered as a securities broker dealer with the SEC and is a member of various SROs and securities exchanges. FINRA serves as Piper Jaffray's primary SRO. Piper Jaffray is subject to the uniform net capital rule of the SEC and the net capital rule of FINRA. Piper Jaffray has elected to use the alternative method permitted by the SEC rule which requires that it maintain minimum net capital of \$1.0 million. Advances to affiliates, repayment of subordinated debt, dividend payments and other equity withdrawals by Piper Jaffray are subject to certain approvals, notifications and other provisions of SEC and FINRA rules.

At December 31, 2018, net capital calculated under the SEC rule was \$222.3 million, and exceeded the minimum net capital required under the SEC rule by \$221.3 million. The Company anticipates \$60.0 million of capital withdrawals within the next six months.

The Company's committed short-term credit facility includes a covenant requiring Piper Jaffray to maintain minimum net capital of \$120 million. CP Notes issued under CP Series II A include a covenant that requires Piper Jaffray to maintain excess net capital of \$100 million. The Company's fully disclosed clearing agreement with Pershing also includes a covenant requiring Piper Jaffray to maintain excess net capital of \$120 million.

Note 17 *Income Taxes*

Deferred income tax assets and liabilities reflect the tax effect of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for the same items for income tax reporting purposes. The net deferred income tax assets consisted of the following items at December 31, 2018:

(Dollars in thousands)

Deferred tax assets:	
Deferred compensation	\$ 63,291
Goodwill and intangible assets tax basis in excess of book basis	11,005
Liabilities/accruals not currently deductible	1,112
Other	5,382
Total deferred tax assets	<u>80,790</u>
Deferred tax liabilities:	
Unrealized gains on firm investments	476
Fixed assets	2,897
Other	555
Total deferred tax liabilities	<u>3,928</u>
Net deferred tax assets	<u>\$ 76,862</u>

The realization of deferred tax assets is assessed and a valuation allowance is recorded to the extent that it is more likely than not that any portion of the deferred tax asset will not be realized. The Company believes that its future tax profits will be sufficient to recognize its deferred tax assets.

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Note 18 *Related Party Transactions*

The Company has significant transactions with the Parent Company and the Parent Company's other subsidiaries. The Company arranges for the purchase or sale of securities, holds investments in funds managed by affiliates and markets derivative instruments for affiliates. The Company allocates expenses or records a portion of the revenues earned by affiliates in return for services provided to affiliates. Certain operating expenses, along with advances for certain investments, incurred by affiliates are initially paid by the Company and subsequently reimbursed by the affiliates. The Company also owns investments in affiliated funds that are accounted for under the equity method. In addition, the Company may transact with the Parent Company for the financing of its operations and reimburses the Parent Company for expenses associated with stock-based compensation awards issued to Company employees. At December 31, 2018, an intercompany payable to the Parent Company of \$66.2 million represents the amounts payable for related party transactions.

Note 19 *Subsequent Events*

On February 25, 2019, the Company signed a definitive agreement to acquire Weeden & Co., L.P., a broker dealer specializing in equity security sales and trading, for total consideration of approximately \$42.0 million, consisting of \$24.5 million in cash and \$17.5 million in restricted cash consideration and retention stock. Additional consideration up to \$31.5 million may be earned if certain revenue targets are achieved. The transaction is expected to close in the second quarter of 2019, subject to regulatory approvals and customary closing conditions.

The Company has evaluated subsequent events through February 26, 2019, the date the financial statements were available to be issued, and has determined there are no other subsequent events that require disclosure in the Company's financial statements.