

EDWARDS A G INC  
Form 10-K  
April 27, 2007

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

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**FORM 10-K**

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.  
*For the fiscal year ended February 28, 2007*  
OR

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

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*Commission file number 1-8527*

*State of Incorporation: DELAWARE • I.R.S. Employer Identification No.: 43-1288229  
One North Jefferson Avenue, St. Louis, Missouri 63103  
Registrant's telephone number, including area code: (314) 955-3000*

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

| Title of each class            | Name of each exchange<br>on which registered |
|--------------------------------|----------------------------------------------|
| COMMON STOCK, \$1 PAR<br>VALUE | NEW YORK STOCK<br>EXCHANGE                   |

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 Exchange 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (Section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the 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. .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Check one:

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Large accelerated filer

Accelerated filer

Non-accelerated filer

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

As of August 31, 2006, the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold was approximately \$4.0 billion.

At April 23, 2007, there were 75,995,890 shares of A.G. Edwards, Inc. common stock, \$1 par value, outstanding.

## DOCUMENTS INCORPORATED BY REFERENCE

Portions of the A.G. Edwards, Inc. Proxy Statement will be filed with the Securities and Exchange Commission (SEC) in connection with the Company's Annual Meeting of Stockholders to be held June 21, 2007, (the Company's 2007 Proxy Statement) are incorporated by reference into Part III hereof, as indicated. Other documents incorporated by reference in this report are listed in the Exhibit Index of this Form 10-K.

### A.G. EDWARDS, INC.

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**PART I**

**ITEM 1. BUSINESS.**

(a) General Development of Business

A.G. Edwards, Inc., a Delaware corporation, is a financial services holding company incorporated in 1983 whose principal subsidiary, A.G. Edwards & Sons, Inc. (the "Company"), is the successor to a partnership founded in 1887. A.G. Edwards, Inc. and its directly owned and indirectly owned subsidiaries (collectively referred to as the "Company") provide securities and commodities brokerage, investment banking, trust services, asset management, financial and retirement planning, insurance products, and other related financial services to individual, corporate, governmental, municipal and institutional clients through one of the industry's largest retail branch distribution systems.

Edwards is a securities broker-dealer whose business, primarily with individual clients, is conducted through one of the largest retail branch office networks (based upon number of offices and financial consultants) in the United States. No single client accounts for a significant portion of Edwards' business. Edwards is a member, has trading privileges or has access to all major securities exchanges in the United States, and is a member of the National Association of Securities Dealers, Inc. (the "NASD") and the Securities Investor Protection Corporation (the "SIPC"). In addition, Edwards has memberships on several domestic commodity exchanges and is registered with the Commodity Futures Trading Commission (the "CFTC") as a futures commission merchant (the "FCM"). In February 2007, Edwards introduced its Federal Depository Insurance Corporation (the "FDIC")-insured bank deposit program (the "AGE Bank Deposit Program") to certain clients as part of a multi-stage rollout to all eligible clients.

A.G. Edwards Trust Company FSB (the "Trust Company") is a federally chartered savings bank that provides investment advisory, portfolio management and trust services. In December 2006, the Trust Company received approval from the Office of Thrift Supervision (the "OTS") to expand its powers to be able to accept time and demand deposits so it can participate, along with several other FDIC-insured banks, in the AGE Bank Deposit Program.

A.G. Edwards & Sons (U.K.) Limited is a securities broker-dealer located in London, England, with an office located in Geneva, Switzerland. A.G. Edwards Capital, Inc. serves as general partner to four private equity partnerships that invest in portfolios of venture capital funds, buy-out funds, and direct investments. A.G. Edwards Technology Group, Inc. provides information technology services to the Company. Beaumont Insurance Company is a Vermont captive insurance company that centralizes certain risk management functions and provides access to reinsurance markets. Gallatin Asset Management, Inc. (the "Gallatin") provides separately managed account and other services to Edwards and markets its investment-management services to unaffiliated mutual-fund firms, pension-fund providers, insurance companies and other financial institutions, including banks and brokerage firms.

(b) Financial Information About Industry Segments

The Company operates and is managed as a single business segment providing investment services to its clients. These services are provided using the same sales and distribution personnel, support services and facilities, and all are provided to meet the needs of its clients. The Company does not identify or manage assets, revenues or expenses resulting from any service, or class of services, as a separate business segment. Financial information related to the Company's single business segment for each of the fiscal years ended February 28, 2007, 2006, and 2005, is included in the consolidated financial statements and notes thereto, such information is hereby incorporated by reference.

(c) Narrative Description of Business

The total amount of revenue by class of products or services that accounted for 10% or more of consolidated net revenues are set forth under Item 6 of this Form 10-K under the caption "Consolidated Five-Year Summary."

**Asset Management and Service Fees**

Asset management and service fee revenues consist primarily of revenues earned for providing support and services in connection with assets under third-party management, including mutual funds, managed futures funds, money market funds, annuities and insurance contracts, as well as revenues from assets under management by the Company. These revenues include fees based on the amount of client assets under management and transaction-related fees as well as fees related to the administration of custodial and other specialty accounts.

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The Company manages client assets through the Trust Company and through Gallatin. The Company offers a non-discretionary advisory program known as Portfolio Advisor and a discretionary advisory program known as FC Advisor. The Company also offers fee-based fund advisory programs that allow clients to select from recommended, established asset allocation models or customize their own models in certain programs. The fund advisory programs are known individually as AGE Allocation Advisors, AGE Pathways, and AGE Professional Fund Advisor. Additionally, the Company offers separately managed accounts and through Gallatin markets its investment-management services to unaffiliated mutual funds, pension-fund providers, insurance companies, and other financial institutions, including banks and brokerage firms.

Edwards has offered clients a fee-based brokerage account known as Client Choice. As a result of a recent court decision, Edwards has stopped opening new Client Choice accounts and is evaluating the status of existing accounts. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information.

Edwards offers the UltraAsset Account and the Cash Convenience Account, which combine a full-service brokerage account with a bank depository account. These programs provide for the automatic investment of customer free credit balances in the AGE Bank Deposit Program or, if a client elects, in one of several tax-exempt money market funds. Interest is not paid on uninvested credit balances held in client accounts. In addition, the UltraAsset Account allows clients access to their margin and depository or money market accounts through the use of debit card and checking account services provided by an unaffiliated major bank. The UltraAsset Account offers additional advanced features and special investment portfolio reports. Clients are provided the opportunity to apply for an A.G. Edwards credit card provided by an unaffiliated major bank.

Edwards also provides custodial services to its clients for the various types of self-directed individual retirement accounts as provided under the Internal Revenue Code of 1986, as amended (the "Internal Revenue Code").

**Commissions**

Commission revenues arise from activities in transaction-based accounts in listed and over-the-counter securities, mutual funds, insurance products, futures, and options. As commissions are transaction-based revenues, they are influenced by the number, size, and market value of client transactions and by product mix.

*Equities.* A significant portion of the Company's net revenue is derived from commissions generated on securities transactions executed by Edwards, as a broker, in common and preferred stocks and debt instruments on exchanges or in the over-the-counter markets. Edwards' brokerage clients are primarily individual investors. Edwards' commission rates for brokerage transactions vary with the size and complexity of the transactions, among other factors.

*Mutual Funds.* Edwards distributes mutual fund shares in continuous offerings of open-end funds. Income from the sale of mutual funds is derived significantly from the standard dealer's discount, which varies as a percentage of the client's purchase price depending on the size of the transaction and terms of the selling agreement. Revenues derived from mutual fund sales continue to be a significant portion of net revenues. Edwards does not sponsor its own mutual fund products.

*Insurance.* As agent for several unaffiliated life insurance companies, Edwards distributes life insurance and tax-deferred annuities.

*Futures and Options.* Edwards acts as broker in the purchase and sale of managed futures, futures contracts, options on futures contracts and option contracts to buy and sell securities, primarily common stock and stock indexes. These contracts cover agricultural products, precious metals, currency, interest rate, energy and stock index futures.

## **Principal Transactions**

Client transactions in the equity and fixed-income over-the-counter markets may be effected by Edwards acting as principal. Principal transactions, including market making, require maintaining inventories of securities to satisfy customer order flow. These securities are valued in the Company's consolidated financial statements at fair value, and unrealized gains or losses are included in the Company's results of operations.

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## **Investment Banking**

Edwards is an underwriter for public offerings of corporate and municipal securities as well as corporate and municipal unit investment trusts and closed-end investment companies. Corporate finance activities are focused on three industry groups: financial institutions and real estate, energy, and emerging growth. Edwards' public finance activities include areas of specialization for municipal and governmental entities in primary and secondary schools, sports and entertainment, municipal finance, housing, higher education, health care, and public utilities. As an underwriter, usually in conjunction with other broker-dealers, Edwards purchases securities for resale to its clients. Edwards acts as an adviser to corporations and municipal entities in reviewing capital needs and determining the most advantageous means for raising capital. It also advises clients in merger and acquisition activities and acts as agent in private placements.

## **Net Interest Revenue**

Interest revenue is derived primarily from financing clients' margin transactions. These revenues are based largely on the amount of client margin balances and the rate of interest charged on these balances. Edwards utilizes a variety of sources to finance client margin accounts, including its stockholders' equity, customer free credit balances and, to the extent permitted by regulations, cash received from net loans of the clients' collateral to other brokers and borrowings from banks, either unsecured or secured by the clients' collateral. The Company also earns revenue from interest and dividend payments on inventory held for sale to clients and short-term investments.

## **Private Client Services**

Edwards' Private Client Services group assists individuals and businesses with a wide range of financial and investment needs. Individual investors can receive tailored asset allocation; tax- and risk-reduction strategies; portfolio reviews of stocks, bonds and mutual funds (including concentrated equity strategies); and

comprehensive financial and estate planning recommendations. Closely held and publicly traded business clients can access services for business insurance, employee benefit programs (retirement plans and key employee compensation), and ownership succession.

### **Investment Activities**

The Company's investment activities primarily include investing in equity and equity-related securities in connection with private investment transactions, either for the accounts of Company-sponsored private equity partnerships or for its own account. These activities include mutual fund investments, including those made in connection with its deferred compensation plan, venture capital investments, and investments in portfolio and operating companies. A.G. Edwards Capital, Inc. is a general partner to the Company-sponsored private equity partnerships and provides them with investment advisory and administrative services. The fair value of the private investments is subject to a higher degree of volatility and management's judgment and may include significant risks of loss while attempting to obtain higher returns than those available from publicly traded securities.

### **Research**

Edwards provides both technical market and fundamental analysis of numerous industries and individual securities for use by its financial consultants and clients. In addition, review and analysis of general economic conditions, along with asset allocation recommendations, are available. These services are provided by Edwards' research analysts, economists, and market strategists.

### **Competition**

All aspects of the Company's business are highly competitive. The Company competes with large, well capitalized providers of financial services. Those companies include other securities firms and affiliates of banks and insurance companies. The Company also competes with a number of discount brokerage firms that offer lower levels of services. The Company believes its competitive advantages lie in its client-first philosophy, service, product offerings, quality of employees and strong reputation.

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The Company's success is largely dependent on its ability to attract and retain qualified employees. These employees, particularly financial consultants, in turn bring new assets and capital management opportunities to the Company.

### **Employees**

At February 28, 2007, the Company had 744 locations in 50 states, the District of Columbia, London, England, and Geneva, Switzerland and 15,338 full-time employees, including 6,618 financial consultants providing services for approximately 3,200,000 active client accounts.

### **Regulation**

The Company as a participant in the financial services business is regulated by federal and state regulatory agencies, self-regulatory organizations and securities exchanges and by foreign governmental agencies and regulatory bodies. Most of these regulations are designed to protect customers and their assets together with integrity of the markets rather than protecting the Company, its shareholders or creditors. Under certain circumstances, these rules may limit the ability of the Company to make withdrawals of capital from subsidiaries or for the subsidiaries to pay dividends to the Company. In addition, the Company because its stock is publicly traded, is subject to the Sarbanes-Oxley Act of 2002 and other laws together with regulations of the SEC and the New York Stock Exchange ("NYSE") governing public disclosure, corporate governance, internal controls and the roles of internal and external auditors and legal counsel.

Edwards, as a broker-dealer and a FCM, is subject to various federal and state laws that regulate virtually all of its activities as a broker-dealer in securities and commodities, as an investment advisor, and as an insurance agent. Edwards is also subject to various regulatory requirements imposed by the securities and commodities exchanges, the NASD and the NYSE. These laws and regulatory requirements generally subject Edwards to standards of solvency with respect to capital requirements, financial reporting requirements, approval of qualifications of personnel engaged in various aspects of its business, record-keeping and business practices, the handling of its clients' funds resulting from securities and commodities transactions, and the extension of credit to clients on margin transactions. Violations of these laws, rules and regulations may result in limitations on certain aspects of Edwards' regulated activities, as well as proceedings of a civil or criminal nature against the firm or employees that could result in the issuance of cease and desist orders, censures, fines or other monetary penalties or the suspension or expulsion from the securities business of the firm, its officers or its employees.

Margin lending by Edwards and other broker-dealers is regulated by the Federal Reserve Board which restricts lending in connection with customer and proprietary purchases and short sales of securities as well as securities borrowing and lending activities. The NASD and NYSE also by rule require minimum maintenance requirements on the value of securities contained in margin accounts. Edwards' margin policies are generally more stringent than these rules.

The commodity futures and commodity options industry in the United States is subject to regulation under the Commodity Exchange Act and by the CFTC charged with administering the act. Edwards is registered with the CFTC. In addition, various self-regulatory organizations including the Chicago Board of Trade ("CBOT") and the Chicago Mercantile Exchange ("CME"), other futures exchanges and the National Futures Association govern the commodity futures and commodity options businesses.

As a registered broker-dealer, Edwards is subject to net capital rules administered by the SEC and the NYSE. Under such rules, this subsidiary must maintain net capital of not less than 2 percent of aggregate debit items, as defined, arising from customer transactions and would be restricted from expanding its business or paying cash dividends or advancing loans to affiliates if its net capital were less than 5 percent of such items. These rules also require Edwards to notify and sometimes obtain approval of the SEC and other regulatory organizations for substantial withdrawals of capital or loans to affiliates. See Note 6 (Net Capital Requirements) of the Notes to the Consolidated Financial Statements for a discussion of Edwards' net capital at February 28, 2007.

The Trust Company and certain other subsidiaries are also subject to minimum capital requirements that may restrict the payment of cash dividends and advances to the Company. The only restriction with regard to the payment of cash dividends by the Company is its ability to obtain cash through dividends and advances from its subsidiaries or borrowings, if needed.

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The Trust Company is a federal savings bank and as such is regulated by the OTS and the FDIC. The OTS imposes minimum capital requirements upon the Trust Company. Until December 2006, the Trust Company was authorized only to accept trust and custodian accounts and not to accept deposits or make loans. In December 2006, the Trust Company received authorization to accept time and demand deposits. The Trust Company currently plans to begin accepting demand deposits in mid-calendar 2007. The acceptance of time and demand deposits will subject the Trust Company to increased regulatory requirements including for additional capital and those governing accepting demand deposits and investing the funds received. A.G. Edwards, Inc. is registered as a holding company with the OTS as a result of owning the Trust Company.

A.G. Edwards & Sons (U.K.) Limited is registered under the laws of the United Kingdom and Switzerland and is regulated as a securities broker-dealer by the Financial Services Authority. A.G. Edwards Capital, Inc. and Gallatin are each registered with the SEC as an investment advisor. Beaumont Insurance Company is regulated by the Vermont Department of Banking, Insurance, Securities and Health Care Administration.

The USA PATRIOT Act of 2001 imposes obligations to detect and deter money laundering and for transparency of financial transactions on broker-dealers and other financial services companies including Edwards and the Trust Company. The obligations include requirements to verify client identification at account opening and to monitor client transactions and report suspicious activities. Anti-money laundering laws outside the United States

impose similar requirements and particularly affect A.G. Edwards & Sons (U.K.) Limited. The anti-money laundering requirements have required the development of extensive internal practices, procedures and controls and any failure could subject the Company, its employees or both to substantial liabilities and fines.

(d) Financial Information About Geographic Areas

Revenues from the Company's non-U.S. operations are currently not material. See Note 12 (Enterprise Wide Disclosure) of the Notes to Consolidated Financial Statements.

(e) Available Information

The Company files annual, quarterly, and current reports, proxy statements, and other information with the SEC.

The public may read and copy the Company's annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and any amendments to these reports filed with the SEC at the SEC's Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. This information may also be obtained from the SEC's web site at [www.sec.gov](http://www.sec.gov).

The Company's web site is [www.agedwards.com](http://www.agedwards.com). The public can access the Company's Investor Relations web page by clicking on About A.G. Edwards and the Investor Relations link. The public can also access the Investor Relations web page directly at [www.agedwards.com/public/content/sc/aboutage/ir/index.html](http://www.agedwards.com/public/content/sc/aboutage/ir/index.html). The Company makes available free of charge its most recent annual reports on Form 10-K, its quarterly reports on Form 10-Q for the current fiscal year, and its most recent proxy statement on its Investor Relations web page. In some cases, these documents may not be available on the Company's web site as soon as they are available on the SEC's web site. The Company also makes available, through its Investor Relations web page, via a link to the SEC's web site, current reports on Form 8-K and statements of beneficial ownership of the Company's equity securities filed by its directors, officers and others under Section 16 of the Securities Exchange Act of 1934 (the "Exchange Act").

**ITEM 1A. RISK FACTORS.**

In the course of conducting business, the Company faces a variety of risks that are inherent to the financial services business. The following is a summary of the risks that management believes are the most significant and could affect the Company's financial condition.

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*Developments in market and economic conditions could adversely affect the Company's business operations and profitability.*

Overall market and economic conditions, which are beyond the Company's control and cannot be predicted with great certainty, generally have a direct impact on client asset valuations and trading activity. In an environment of adverse or uncertain market or economic conditions, the Company could experience decreased trading volumes, decreased fee-based and commission revenue, and decreased profitability.

*The Company may not be able to successfully compete against the other companies within the financial services industry.*

The financial services industry has been, and will likely continue to be, intensely competitive. The Company generally competes on the basis of its strong reputation, client-first philosophy and superior service, quality of employees, and range of product and service offerings. The Company competes for business with financial services firms that have greater financial resources and global operations, allowing them to potentially take on more risk and earn higher returns. The Company also competes with companies offering online and discount brokerage services and with banks and bank-affiliated brokerage companies that increasingly are using



brokerage services, sometimes at reduced or no cost to customers, to attract clients for bank services. In the event that the Company cannot successfully compete with these financial services firms on one or more of the previously mentioned factors, it may face a reduction in market share, a reduction in revenues, and/or a reduction in profitability.

*The Company may not be able to attract, develop, and retain highly qualified and productive employees.*

The Company's employees are its most important assets, and competition for qualified employees is fiercely competitive, especially for successful financial consultants. If the Company cannot continue to attract and retain high quality employees, or if the costs to attract and retain high quality employees rise due to competition, the Company's business operations and financial performance could be adversely impacted.

*The Company's business may be adversely affected if its reputation is damaged.*

As a participant in the financial services industry, the Company must maintain a high quality reputation in order to attract and retain clients and employees. If the Company fails, or appears to fail, to conduct its business activities in a fair and ethical manner or to associate with appropriate clients and counterparties, the Company could experience adverse effects to its business operations and financial results.

*The Company's business operations and financial condition could be adversely affected if it is unable to access funds in a timely or cost-effective manner.*

Efficient access to funds is critical to the Company's business operations, particularly margin lending and trading activities. The Company's funding needs are primarily met through cash generated from operations and cash obtained from external sources (e.g., bank lending and securities lending). The Company's access to this financing could be impaired by Company-specific factors, such as weakened opinion of the Company by external financing sources, or by factors affecting the financial services industry in general, such as a severe market disruption. An inability to access the necessary funds at a reasonable cost could negatively impact the Company's business activities and financial condition.

*External events and failures in technology or in operational processes could expose the Company to business disruptions, reduced financial results, litigation, and regulatory actions.*

The Company relies on its systems and operational processes to process numerous transactions on a daily basis across various different markets. In addition, the Company relies on third-party vendors to conduct significant portions of its trade processing and back office processing. In the event of a breakdown in an operational process (e.g., human error or employee misconduct), a malfunction of the Company's systems or the third-party vendors' systems, or an inability to recover from external events beyond the Company's control, such as a natural disaster, the Company could suffer business and financial losses and be subject to litigation and regulatory actions.

*The Company's financial performance could be adversely impacted by fluctuations in interest rates and/or equity prices.*

The Company is exposed to variability in the value of financial instruments caused by volatility in interest rates and/or equity prices. The primary source of this exposure is in the inventories of fixed-income and equity securities that the Company maintains in order to facilitate customer securities transactions. The Company could experience financial losses if adverse movements in interest rates and/or equity prices cause a decline in the valuations of its securities inventories.

*The Company's financial performance could be adversely impacted by credit exposures.*

The Company is exposed to the possibility that a client or counterparty is unable to meet its obligations to the Company, or that the value of collateral supporting an obligation to the firm declines such that the collateral is no longer sufficient to support the obligation. The Company's exposure primarily results from its activities relating to

margin lending, to its role as a counterparty to financial transactions, and to its securities inventories. The lack of performance by clients and/or counterparties could adversely impact the Company's profitability.

*The Company's reputation and business performance could be adversely impacted if it is unable to sufficiently protect the critical information of its clients.*

In order to provide effective service to clients, the Company gathers clients' personal information in the normal course of business. If clients perceive that the Company does not maintain this personal information in a secure manner they may not be willing to do business with the Company. If there is a breach in the Company's protection of clients' personal information through a breach in the information technology network or otherwise, the Company could suffer significant damage to its reputation and be subject to litigation and regulatory actions.

*The Company could suffer adverse impacts to its business activities, financial performance, and reputation if it is subject to one or more significant regulatory actions.*

As a member of the financial services industry, the Company's activities are subject to extensive regulation by federal and state regulatory bodies, securities exchanges, and other self-regulatory organizations. This regulation has been increasing and becoming more complex in recent years. One or more significant regulatory actions brought against the Company could result in censures, fines, civil or criminal liability, or temporary or permanent prohibition from participating in certain types of business activities, any of which could have material adverse impacts on the Company's business operations, financial results, and reputation. New laws or regulations or changes to existing laws or regulations could also adversely impact the Company's business.

*The Company could be negatively impacted as a result of litigation.*

In the ordinary course of business, the Company is subjected to various legal actions. These include claims of recommending unsuitable investments to clients, unauthorized or excessive trading on behalf of clients, or human resource related claims by current or former employees. In the event that the Company is liable for significant settlements or awards, the Company's business operations, financial performance, and reputation could be adversely affected.

#### **ITEM 1B. UNRESOLVED STAFF COMMENTS.**

None.

#### **ITEM 2. PROPERTIES.**

The Company's headquarters are located at One North Jefferson Avenue, St. Louis, Missouri, 63103. It consists of several buildings owned by the Company, which contain approximately 2,600,000 square feet of general office space as well as underground and surface parking and two parking garages. In addition, the Company owns an office building in the St. Louis area, which is used primarily as a contingency planning facility. The Company also leases 35,700 square feet in lower Manhattan and 7,000 square feet in downtown Chicago for the Company's security and commodity trade-processing activities. The Company occupies 744 locations, which are, with a few exceptions, leased premises, throughout the United States as well as in London, England, and Geneva, Switzerland.

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#### **ITEM 3. LEGAL PROCEEDINGS.**

(a) Litigation

The Company is a defendant in a number of lawsuits, in some of which plaintiffs claim substantial amounts, relating primarily to its securities and commodities business. Management has determined that it is likely that ultimate resolution in favor of the plaintiffs will result in losses to the Company on certain of these claims and as a result, establishes accruals for potential litigation losses. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in

adverse judgments, fines or penalties. Factors considered by management in estimating the Company's reserves for these matters are the loss and damages sought by the plaintiffs, the merits of the claims, the total cost of defending the litigation, the likelihood of a successful defense against the claims, and the potential for fines and penalties from regulatory agencies. The Company establishes reserves for potential losses to the extent that such matters are probable and can be estimated, in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies." As litigation and the resolution of regulatory matters are inherently unpredictable, the Company cannot predict with certainty the ultimate loss or range of loss where there is only a reasonable possibility that a loss may be incurred. The Company believes, based on current knowledge and after consultation with legal counsel, that the resolution of loss contingencies will not have a material adverse effect on the consolidated balance sheet, statement of earnings or statement of cash flows of the Company. However, the outcome of such matters could be material to the Company's operating results and cash flows for a future or interim periods, depending, among other things, on the results of operations for these periods.

Edwards has received information requests or subpoenas from the SEC, the NASD, the NYSE, several states and the United States Department of Justice with respect to mutual fund transactions that involve market timing, late trading or both. The SEC, the NASD and certain states have examined certain branch offices and have or will take statements from employees of Edwards in connection with such mutual fund transactions. In addition, Edwards has received requests for information concerning timing of mutual fund transactions in variable annuity sub accounts. The staff of the SEC has informed Edwards that it intends to recommend that a civil injunctive action be brought against Edwards with respect to mutual fund transactions occurring prior to October 2003 and alleged to involve market timing.

The Commonwealth of Massachusetts filed in February 2005 an administrative complaint against Edwards concerning certain mutual fund transactions in Edwards' Boston-Back Bay office. The complaint alleges violations of securities laws by mutual fund market timing transactions and seeks a cease and desist order, an administrative fine in an unspecified amount, compensation to mutual fund holders for losses alleged to have resulted from market timing, and other relief.

The State of Illinois Secretary of State Securities Department sent a Notice of Hearing dated December 1, 2006 that alleges, among other matters, that Edwards engaged in activities to facilitate mutual fund market timing on behalf of certain clients from January 2001 to October 2003 and had inadequate procedures to detect and prevent late trading of mutual funds in violation of the Illinois Securities Law of 1953. The matter is set for hearing in May 2007. Other regulatory actions or claims may occur related to market timing or other mutual fund activities.

Edwards has been named as a defendant in a lawsuit that seeks class-action status filed in the state of Missouri that alleges, among other matters, that mutual fund transactions with certain customers were influenced by undisclosed shared revenue payments. Edwards is defending itself against the suit.

The NASD in fiscal year 2006 advised Edwards that it has made a preliminary determination to recommend that disciplinary action be brought against Edwards concerning the sale of mutual fund class-B shares and class-C shares based upon, it is believed, the grounds for recommending such sales, suitability violations, and Edwards supervisory procedures. The NASD orally proposed a settlement, including a fine, the offer to customers to switch to class-A shares and reimbursement for any disadvantage based on actual performance and the retention of an independent consultant to review supervisory procedures. Edwards did not accept the settlement.

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The NASD filed in November 2005 an administrative complaint against Edwards concerning the sale of certain mutual funds to IRA accounts in 2001 and 2002 for which certain mutual fund companies made additional cash payments alleged to total \$630,958 to Edwards for sales. The complaint seeks unspecified sanctions and restitution. Edwards is defending itself against the charges. The matter is currently being tried before a hearing panel under the procedures of the NASD.

The Attorney General of South Carolina, Securities Division, filed an administrative proceeding in August 2005 against Edwards and two former employees in connection with actions taken from 1995 until 2002 involving securities transactions with residents of South Carolina by financial consultants in Edwards' Augusta, Georgia branch. Edwards has reached oral agreement to resolve this matter and matters relating to an Edwards branch in South Carolina by payment of \$575,000. In March 2004, Edwards agreed under a consent order with the Georgia

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Secretary of State's Securities and Business Regulation Division to make certain payments to the State of Georgia and to customers related to transactions in the Augusta, Georgia branch. Edwards has made payments in excess of \$38.2 million to customers and to the State of Georgia related to these matters. Edwards believes the actions involved in these matters were isolated to one branch and a limited number of financial consultants formerly with Edwards and had no connection with any other Edwards office.

On August 7, 2006, NYSE Regulation, Inc. censured and fined Edwards \$900,000 (with a previous payment to another regulator deemed to satisfy \$400,000 of the fine) for improperly maintaining customers in non-managed fee-based accounts, for failing to supervise a branch manager and for failing to properly report certain statistical information concerning customer complaints. Edwards made restitution to certain clients of fees previously charged in the amount of \$830,000. The issues from the examinations include alleged failure to supervise charges related to the firm's Augusta, Georgia branch related to the matters described above, alleged failure to properly report customer complaints, and alleged failures to supervise Edwards' Client Choice accounts, including supervision of accounts with limited trading activity and accounts with concentrations of mutual funds. Client Choice accounts are brokerage accounts for which a fee, rather than commissions, is charged.

Edwards and other financial services firms were asked by the SEC to voluntarily review the supervision and operation of certain auction rate securities transactions. Thereafter, on May 31, 2006, the SEC instituted proceedings against Edwards and 14 other financial firms alleging that each of the firms had violated Section 17(a)(2) of the Securities Act of 1933 in connection with transactions involving auction rate securities. Simultaneously with the institution of such proceedings, each of the firms, without admitting or denying the findings of the SEC, consented to censure, undertakings and monetary penalties. Edwards was required to pay \$125,000.

Edwards and other financial services firms have received and responded to information requests from the NYSE with respect to delivery of prospectuses to customers. Regulatory actions or claims may result from the information developed during the review by the NYSE.

The Division of Enforcement of the NASD had informed Edwards that it was considering recommending disciplinary action against the firm in connection with what was alleged to be the failure to establish adequate supervisory procedures related to the suitability of variable annuity products. In April 2007, Edwards was informed that the Division of Enforcement of the NASD closed their investigation of this matter and will not recommend the commencement of disciplinary action.

Edwards and other firms in the industry were asked by a number of regulators and exchanges to assess their policies, procedures and filings in response to electronic "blue sheet" inquiries. Blue sheet inquiries are inquiries concerning trading in particular securities. Edwards has filed its assessment. Regulatory actions or claims may result from information developed during the assessment.

A former employee filed an action in September 2005 against the Company seeking class certification alleging, among other matters, violations of the Employee Retirement Income Security Act by allegedly failing to minimize fees paid in connection with investments in the Company's Retirement and Profit Sharing Plan and by the selection of mutual funds for investments in the plan. The Company is defending itself against the suit.

Edwards is a defendant in a complaint filed in the United States District Court for the Southern District of California that seeks to be a class action on behalf of all financial consultants and trainees who worked for Edwards in California after June 30, 2000. The action, among other relief, seeks overtime pay for financial consultants, including trainees, on the basis that the financial consultants should be classified as non-exempt

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employees under California law, restitution of amounts that were deducted from commissions owed to financial consultants to repay advances made in prior months, payment for meal rest breaks to which financial consultants are claimed to be entitled, and reimbursement for certain alleged business-related expenses paid by financial consultants. Several other financial services firms have been sued in California in similar actions, some of which have settled the actions for substantial amounts. Other financial firms have announced changes in compensation for and charges to financial consultants as the result of such litigation. Edwards is evaluating whether changes will be made to compensation for and charges to financial consultants. Any such changes might increase

expenses for Edwards.

In addition, Edwards has been named as defendants in separate lawsuits filed in the United States District Court for the Northern District of New York, the United States District Court of New Jersey, the United States District Court for the District of Oregon, the United States District Court for the Western District of Pennsylvania, and the Court of Common Pleas of Allegheny County Pennsylvania. Each of the suits seeks to be a class action on behalf of defined groups of financial consultants or employees being trained to be financial consultants during specified periods that vary in each lawsuit. Each of the suits seeks, among other relief, overtime pay for the purported class members and two of the suits seek reimbursement of certain amounts deducted from commissions allegedly owed the employees or paid by the employees.

The Division of Enforcement of the NYSE has informed Edwards that it is considering bringing a formal disciplinary action against Edwards relating to Edwards' stock loan business. The disciplinary action being considered is stated, among other matters, to relate to alleged failures to detect and prevent stock loan personnel from engaging in away-from-market stock loan transactions and from engaging in business dealings with finders in violation of firm policy, failing to detect and prevent conflicts of interest between stock loan personnel and their counterparties, failing to ensure adequate review of electronic communications and to retain facsimile transmissions related to the stock loan business and failing to review certain employee trades. Edwards has been offered the opportunity to make a Wells-type submission.

(b) Proceedings Terminated During the Fourth Quarter of the Fiscal Year Covered by This Report

Not Applicable.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.**

There were no matters submitted to a vote of security holders during the fourth quarter of the fiscal year ended February 28, 2007.

**EXECUTIVE OFFICERS OF THE COMPANY**

The following table sets forth the executive officers of the Company as of April 27, 2007, as determined by the Board of Directors.

| Name              | Age | Office and Title                                                                                                                                                                                                                                                              | Year First Appointed Executive Officer of the Company |
|-------------------|-----|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------|
| Robert L. Bagby   | 63  | Chairman of the Board and Chief Executive Officer of the Company and Edwards since 2001. Vice Chairman of the Board, Executive Vice President and Director of the Branch Division of Edwards prior to 2001. Employee of Edwards for 32 years. Director of Edwards since 1979. | 1991                                                  |
| Ronald J. Kessler | 59  | Vice Chairman of the Board of the Company and Edwards since 2001. Executive Vice President and Director of the Operations Division of Edwards. Employee of Edwards for 39 years. Director of Edwards since 1989.                                                              | 1996                                                  |
| Mary V. Atkin     | 52  | Director of the Staff Division of Edwards since 2005. Executive Vice President of Edwards since 2001.                                                                                                                                                                         | 1999                                                  |

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|  |  |                                                                                                                                                                                                                                                                      |  |
|--|--|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|
|  |  | Director of Corporate Strategy from November 2003 to February 2005. President of A.G. Edwards Technology Group, Inc. from 2001 to 2003. Director of A.G. Edwards Technology Group Inc. since 1999. Employee of Edwards for 29 years. Director of Edwards since 1993. |  |
|--|--|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--|

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| Name               | Age | Office and Title                                                                                                                                                                                                                                                                                                                                                            | Year First Appointed Executive Officer of the Company |
|--------------------|-----|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------|
| Gene M. Diederich  | 48  | Executive Vice President of Edwards since 2005. Director of the Branch Division of Edwards since March 2005. Regional Manager of Edwards from 2002 to 2005. Branch Manager of Edwards from 1996 to 2002. Employee of Edwards for 22 years. Director of Edwards since 2003.                                                                                                  | 2005                                                  |
| Charles J. Galli   | 66  | Senior Vice President of Edwards. Regional Manager. Employee of Edwards for 28 years. Director of Edwards since 1990.                                                                                                                                                                                                                                                       | 2001                                                  |
| Alfred E. Goldman  | 73  | Corporate Vice President of Edwards, Director of Market Analysis of Edwards. Employee of Edwards for 47 years. Director of Edwards since 1967.                                                                                                                                                                                                                              | 1991                                                  |
| Richard F. Grabish | 58  | Chairman and Chief Executive Officer of A.G. Edwards Trust Company since 2001. President of A.G. Edwards Trust Company since 2005 and from 1987 to 2001. Senior Vice President of Edwards. Assistant Director of the Sales and Marketing Division of Edwards. Employee of Edwards for 26 years. Director of Edwards since 1988.                                             | 2001                                                  |
| Douglas L. Kelly   | 58  | Vice President, Secretary, Chief Financial Officer and Treasurer of the Company since 2001. Executive Vice President, Secretary, Director of the Law and Compliance Division of Edwards since 1994. Chief Financial Officer, Treasurer and Director of the Administration Division of Edwards since 2001. Employee of Edwards for 13 years. Director of Edwards since 1994. | 1994                                                  |
| Peter M. Miller    | 49  | Executive Vice President and Director of the Sales and Marketing Division of                                                                                                                                                                                                                                                                                                | 2002                                                  |

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|                  |    |                                                                                                                                                                                                                                                                                                                                     |      |
|------------------|----|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|
|                  |    | Edwards since 2002. Regional Manager of Edwards from 1995 to 2002. Employee of Edwards for 18 years. Director of Edwards since 1997.                                                                                                                                                                                                |      |
| John C. Parker   | 47 | Executive Vice President of Edwards since 2003. Director and President of A.G. Edwards Technology Group, Inc. since November 2003. Senior Vice President of A.G. Edwards Technology Group, Inc. from 2001 to 2003. Employee of Edwards for five years. Director of Edwards since 2002.                                              | 2003 |
| Paul F. Pautler  | 61 | Executive Vice President and Director of the Capital Markets Division of Edwards since 2001. Senior Vice President and Director of the Investment Banking Division of Edwards from 2000 to 2001. Director of Corporate Finance of Edwards from 1999 to 2001. Employee of Edwards for nine years. Director of Edwards since 2000.    | 2000 |
| Joseph G. Porter | 46 | Assistant Treasurer and Assistant Secretary of the Company since 1999. Vice President of the Company since 2002. Principal Accounting Officer of the Company and Edwards. Senior Vice President and Assistant Director of the Administration Division of Edwards. Employee of Edwards for 24 years. Director of Edwards since 2001. | 1999 |

**PART II**

**ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.**

**Quarterly Information**  
(Unaudited)

|                               | <b>Dividends Declared</b> | <b>Stock Price Sales Price</b> | <b>Net Revenues</b>  | <b>Earnings Before Tax</b> | <b>Net Earnings</b>  | <b>Earnings Per Share</b> |              |
|-------------------------------|---------------------------|--------------------------------|----------------------|----------------------------|----------------------|---------------------------|--------------|
|                               | <b>per Share</b>          | <b>High-Low</b>                | <b>(In millions)</b> | <b>(In millions)</b>       | <b>(In millions)</b> | <b>Diluted</b>            | <b>Basic</b> |
| <b>Fiscal 2007 by Quarter</b> |                           |                                |                      |                            |                      |                           |              |
| First                         | \$0.20                    | \$54.56 - \$43.17              | \$764.7              | \$ 122.4                   | \$ 77.6              | \$1.01                    | \$1.0        |
| Second                        | \$0.20                    | \$56.17 - \$47.77              | \$713.3              | \$ 104.4                   | \$ 66.3              | \$0.86                    | \$0.8        |
| Third                         | \$0.20                    | \$59.93 - \$51.55              | \$767.5              | \$ 124.0                   | \$ 78.3              | \$1.03                    | \$1.0        |
| Fourth                        | \$0.20                    | \$69.04 - \$56.70              | \$865.0              | \$ 169.8                   | \$ 109.2             | \$1.44                    | \$1.4        |

**Fiscal 2006\* by Quarter**

|        |        |                   |         |          |         |        |       |
|--------|--------|-------------------|---------|----------|---------|--------|-------|
| First  | \$0.16 | \$45.70 - \$38.66 | \$652.9 | \$ 75.9  | \$ 51.8 | \$0.67 | \$0.6 |
| Second | \$0.16 | \$47.00 - \$40.94 | \$672.5 | \$ 74.3  | \$ 47.2 | \$0.61 | \$0.6 |
| Third  | \$0.20 | \$46.73 - \$38.41 | \$674.1 | \$ 75.8  | \$ 51.7 | \$0.67 | \$0.6 |
| Fourth | \$0.20 | \$48.04 - \$43.86 | \$740.6 | \$ 115.0 | \$ 75.4 | \$0.99 | \$0.9 |

See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information on the components presented above.

\*Fiscal 2006 amounts have been adjusted due to a change in accounting method. See Note 2 (Employee Stock Plans) of the Notes to Consolidated Financial Statements for a detailed discussion of the Company's Stock-Based Compensation plan.

**Issuer Purchases of Equity Securities**

The following table presents the number of shares purchased monthly under the Company's stock repurchase programs for the three-month period ended February 28, 2007.

| Period                           | Total Number of Shares Purchased | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans | Maximum Number of Shares That May Yet Be Purchased Under the Plans |
|----------------------------------|----------------------------------|------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------------|
| December<br>(12/1/06 - 12/31/06) | 361,356                          | \$61.15                      | 361,356                                                              | 4,577,210                                                          |
| January<br>(1/1/07 - 1/31/07)    | 354,590                          | \$66.26                      | 354,590                                                              | 14,222,620                                                         |
| February<br>(2/1/07 - 2/28/07)   | 288,246                          | \$66.99                      | 288,246                                                              | 13,934,374                                                         |
| Total                            | 1,004,192                        | \$64.63                      | 1,004,192                                                            |                                                                    |

In November 2004, the Company's Board of Directors authorized the repurchase of up to 10,000,000 shares of the Company's outstanding common stock during the period November 19, 2004, through December 31, 2006. The Company purchased 6,203,611 shares under the November 19, 2004 authorization. In November 2006, the Company's Board of Directors authorized the repurchase of up to 10,000,000 shares of the Company's outstanding stock during the period January 1, 2007 through December 31, 2008. At February 28, 2007, the Company had up to 9,419,832 shares available for repurchase under the January 2007 authorization.

In May 2005, the Board of Directors authorized the repurchase of up to 5,000,000 shares of the Company's outstanding common stock solely to effect employee stock transactions in the Company's Retirement and Profit Sharing Plan during the period May 24, 2005, through May 31, 2008. At February 28, 2007, the Company had up to 4,514,542 shares available to repurchase under this authorization.

**Annual Meeting**

The 2007 Annual Meeting of Stockholders (the "Annual Meeting") will be held at the Company's headquarters, One North Jefferson, St. Louis, Missouri, on Thursday, June 21, 2007, at 10 a.m. CDT. The Notice of Annual Meeting, Proxy Statement and Proxy Voting Card will be mailed on or around May 15, 2007, to each stockholder



of record at the close of business on May 1, 2007. The Proxy Statement describes the items of business to be voted on at the Annual Meeting and provides information on the Board of Directors' nominees for director and their principal affiliations with other organizations as well as other information about the Company.

### Dividend Payment

The next four anticipated dividend payment dates are July 2 and October 1, 2007, and January 2 and April 1, 2008. However, the payment and rate of dividends on the Company's common stock is subject to several factors including operating results, financial requirements of the Company, and the availability of funds from the Company's subsidiaries, which may be subject to restrictions under the net capital rules of the SEC and NYSE and the capital adequacy requirements of the OTS. Such restrictions have never become applicable with respect to the Company's dividend payments. See Note 6 (Net Capital Requirements) of the Notes to Consolidated Financial Statements for more information on the capital restrictions placed on the Company and its subsidiaries.

### Stock Exchange Listing

The Company's common stock is listed on the NYSE under the symbol AGE. The approximate number of stockholders on February 28, 2007, was 19,300. The approximate number of stock holders of record includes customers who hold the Company's stock in their accounts on the books of Edwards.

### Registrar/Transfer Agent

The Bank of New York  
1-800-524-4458  
1-212-815-3700 (Outside the U.S. and Canada)  
1-888-269-5221 (Hearing Impaired ☐ TTY Phone)

e-mail: [shareowners@bankofny.com](mailto:shareowners@bankofny.com)  
website: <https://www.stockbny.com>

Address Shareholder Inquiries to:  
The Bank of New York  
Investor Services Department  
P.O. Box 11258  
New York, New York 10286-1258

Send Certificates for Transfer and Address Changes to:  
Receive and Deliver Department  
P.O. Box 11002  
New York, NY 10286-1002

## ITEM 6. SELECTED FINANCIAL DATA.

### Consolidated Five-Year Summary

| Year Ended                         | February<br>28,<br>2007 | February<br>28,<br>2006<br>(As<br>Adjusted)* | February<br>28,<br>2005 | February<br>29,<br>2004 | February<br>28,<br>2003 |
|------------------------------------|-------------------------|----------------------------------------------|-------------------------|-------------------------|-------------------------|
| <b>Revenues</b>                    |                         |                                              |                         |                         |                         |
| Asset management and service fees: |                         |                                              |                         |                         |                         |
| Distribution fees                  | \$ 684,290              | \$ 571,573                                   | \$ 498,026              | \$ 366,735              | \$ 336,636              |
| Fee-based accounts                 | 474,532                 | 386,585                                      | 323,769                 | 246,943                 | 225,888                 |

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|                                                                        |            |            |            |            |            |
|------------------------------------------------------------------------|------------|------------|------------|------------|------------|
| Service fees                                                           | 107,240    | 104,714    | 97,282     | 109,708    | 90,493     |
| Total                                                                  | 1,266,062  | 1,062,872  | 919,077    | 723,386    | 653,017    |
| <b>Commissions:</b>                                                    |            |            |            |            |            |
| Equities                                                               | 539,208    | 530,052    | 530,654    | 543,462    | 453,231    |
| Mutual funds                                                           | 244,031    | 242,883    | 259,179    | 260,518    | 201,567    |
| Insurance                                                              | 200,956    | 195,476    | 192,019    | 205,622    | 185,249    |
| Futures and options                                                    | 46,689     | 48,411     | 47,810     | 51,427     | 42,816     |
| Other                                                                  | 1,073      | 894        | 4,504      | 19,998     | 5,116      |
| Total                                                                  | 1,031,957  | 1,017,716  | 1,034,166  | 1,081,027  | 887,979    |
| <b>Principal transactions:</b>                                         |            |            |            |            |            |
| Debt securities                                                        | 127,720    | 131,284    | 178,395    | 217,224    | 252,688    |
| Equities                                                               | 87,410     | 78,826     | 75,504     | 79,662     | 58,436     |
| Total                                                                  | 215,130    | 210,110    | 253,899    | 296,886    | 311,124    |
| <b>Investment banking:</b>                                             |            |            |            |            |            |
| Underwriting fees and selling concessions                              | 196,593    | 168,963    | 174,555    | 240,094    | 184,220    |
| Management fees                                                        | 93,295     | 65,434     | 71,067     | 81,767     | 66,960     |
| Total                                                                  | 289,888    | 234,397    | 245,622    | 321,861    | 251,180    |
| <b>Interest:</b>                                                       |            |            |            |            |            |
| Margin account balances                                                | 146,194    | 138,466    | 107,611    | 74,662     | 86,189     |
| Securities owned and deposits                                          | 85,103     | 42,871     | 21,132     | 21,470     | 20,474     |
| Total                                                                  | 231,297    | 181,337    | 128,743    | 96,132     | 106,663    |
| Other                                                                  | 91,743     | 44,334     | 30,288     | 6,384      | 10,239     |
| Total Revenues                                                         | 3,126,077  | 2,750,766  | 2,611,795  | 2,525,676  | 2,220,202  |
| Interest expense                                                       | 15,617     | 10,653     | 4,114      | 2,859      | 5,850      |
| Net Revenues                                                           | 3,110,460  | 2,740,113  | 2,607,681  | 2,522,817  | 2,214,352  |
| <b>Non-Interest Expenses</b>                                           |            |            |            |            |            |
| Compensation and benefits                                              | 1,931,870  | 1,761,199  | 1,699,156  | 1,642,999  | 1,448,199  |
| Communication and technology                                           | 257,838    | 236,379    | 241,830    | 272,047    | 282,603    |
| Occupancy and equipment                                                | 150,464    | 144,114    | 151,426    | 137,617    | 134,149    |
| Marketing and business development                                     | 76,950     | 71,635     | 65,682     | 53,262     | 45,649     |
| Floor brokerage and clearance                                          | 19,101     | 21,073     | 21,341     | 22,495     | 22,464     |
| Other                                                                  | 153,644    | 164,705    | 133,839    | 149,123    | 109,854    |
| Total Non-Interest Expenses                                            | 2,589,867  | 2,399,105  | 2,313,274  | 2,277,543  | 2,042,918  |
| Earnings Before Income Taxes                                           | 520,593    | 341,008    | 294,407    | 245,274    | 171,434    |
| Income Taxes                                                           | 189,240    | 117,684    | 107,933    | 85,789     | 52,606     |
| Earnings before cumulative effect of accounting change                 | 331,353    | 223,324    | 186,474    | 159,485    | 118,828    |
| Cumulative effect of accounting change, net of \$1,655 of income taxes |            | 2,768      |            |            |            |
| Net earnings                                                           | \$ 331,353 | \$ 226,092 | \$ 186,474 | \$ 159,485 | \$ 118,828 |

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| Year Ended                  | February 28, | February 28,        | February 28, | February 29, | February 28, |
|-----------------------------|--------------|---------------------|--------------|--------------|--------------|
|                             | 2007         | 2006 (As Adjusted)* | 2005         | 2004         | 2003         |
| Earnings per diluted share: |              |                     |              |              |              |

(In thousands, except per share amounts)

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|                                                              |              |              |              |              |              |
|--------------------------------------------------------------|--------------|--------------|--------------|--------------|--------------|
| Earnings before cumulative effect of accounting change       | \$ 4.34      | \$ 2.89      | \$ 2.37      | \$ 1.97      | \$ 1.46      |
| Cumulative effect of accounting change, net of income taxes* | □            | 0.04         | □            | □            | □            |
| Earnings per diluted share                                   | \$ 4.34      | \$ 2.93      | \$ 2.37      | \$ 1.97      | \$ 1.46      |
| <b>Per Share Data:</b>                                       |              |              |              |              |              |
| Dividends Declared                                           | \$ 0.80      | \$ 0.72      | \$ 0.64      | \$ 0.64      | \$ 0.64      |
| Book Value                                                   | \$ 27.91     | \$ 24.96     | \$ 23.21     | \$ 22.08     | \$ 20.92     |
| <b>Other Data:</b>                                           |              |              |              |              |              |
| Total Assets                                                 | \$ 5,312,118 | \$ 4,671,643 | \$ 4,687,797 | \$ 4,436,085 | \$ 3,980,094 |
| Stockholders' Equity                                         | \$ 2,102,039 | \$ 1,887,012 | \$ 1,787,691 | \$ 1,778,319 | \$ 1,688,537 |
| Dividends Declared                                           | \$ 60,664    | \$ 54,894    | \$ 49,392    | \$ 51,007    | \$ 51,034    |
| Pre-tax Return on Average Equity                             | 26.1%        | 18.6%        | 16.5%        | 14.1%        | 10.3%        |
| Return on Average Equity                                     | 16.6%        | 12.3%        | 10.5%        | 9.2%         | 7.1%         |
| <b>Pre-tax Net Earnings as a Percent of Net</b>              |              |              |              |              |              |
| Revenues                                                     | 16.7%        | 12.4%        | 11.3%        | 9.7%         | 7.7%         |
| <b>Average Common and Common Equivalent</b>                  |              |              |              |              |              |
| Shares Outstanding (Diluted)                                 | 76,431       | 77,204       | 78,766       | 80,990       | 81,177       |

\*Fiscal 2006 amounts have been adjusted due to a change in accounting method. See Note 2 (Employee Stock Plans) of the Notes to Consolidated Financial Statements for a detailed discussion of the Company's Stock-Based Compensation plan.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

(Year references, including those in charts, are to fiscal years ended February 28 unless otherwise specified)

#### Introduction

Headquartered in St. Louis, Missouri, A.G. Edwards, Inc. is a financial services holding company whose principal operating subsidiary is the national investment firm of A.G. Edwards & Sons, Inc. (Edwards), which is a successor to a partnership formed in 1887. A.G. Edwards, Inc. and its operating subsidiaries (collectively, the Company), provide securities and commodities brokerage, investment banking, trust services, asset management, retirement and financial planning, insurance products, and other related financial services.

The Company's client base is comprised mostly of individual investors and includes corporations, governments, municipalities and financial institutions. Total client assets at the end of 2007 were \$374 billion, an increase of \$31 billion (9 percent) when compared to the end of 2006.

The Company serves its clients through one of the securities industry's largest branch-office networks with locations in all 50 states, the District of Columbia, London, England and Geneva, Switzerland. The Company added six locations during 2007, increasing its total to 744. The total number of full-time employees decreased by 142 (1 percent) to end the year at 15,338. The number of the Company's financial consultants declined 206 (3 percent) to end the year at 6,618. Average client assets per financial consultant at the end of 2007 were \$56.5 million, an increase of \$6.2 million (12 percent).

#### Executive Summary

##### *Economic/Market Conditions*

As the fiscal year progressed and the economic data turned more positive, the actions of investors suggested they were becoming more comfortable with the economic and market environments. While the first four months of the fiscal year were largely dominated by rising interest rates and rising oil prices, along with economic data that provided no clear indication of the economy's direction, the last eight months displayed much of the opposite.

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After raising the Federal Funds rate from 4.75 percent to 5.25 percent from March to June, the Federal Reserve held the rate steady from June through the end of February. Crude oil prices, which peaked at more than \$77 per barrel in July, hovered in the \$58-\$63 range for much of the fiscal third quarter, fell as low as \$50 per barrel in the fourth quarter, and closed the year at \$62 per barrel. Consumer price inflation increased at its smallest monthly rates during the last six months of the year, and Gross Domestic Product growth maintained slower, steadier progress from April to December, further relaxing concerns of additional Federal Funds rate increases.

The positive economic news later in the year was reflected in the equity markets. While the major stock market indexes posted modest gains through the first six months, their fiscal-year highs and the bulk of the overall gains came within the last six months. It should be noted that the fiscal-year results for these indexes were adversely affected by heavy stock-selling in the last week of the fiscal year. The Standard & Poor's 500 Index increased 126 points (10 percent), gaining 103 of those points (8 percent) in the last six months, to finish the year at 1,407. Similarly, the Dow Jones Industrial Average increased 1,275 points (12 percent), gaining 888 points (8 percent) in the last six months, to finish at 12,269. The Nasdaq Composite Index, meanwhile, was at a 4 percent loss through the first six months before ending the year with a 135-point (6 percent) increase to finish at 2,416.

#### *Regulatory Environment*

The enactment of new or changes in existing laws or regulations, new or changed interpretations or enforcement of such laws or regulations, or court decisions concerning them in the U.S. or in other jurisdictions could materially affect the Company's business, financial condition or results of operations in one or more periods. Recent changes include the New York Stock Exchange (NYSE) and the National Association of Securities Dealers, Inc. (NASD), which have regulatory authority over the business of Edwards as a broker-dealer, announcing that they intend to merge their regulatory operations into a single regulatory body that is expected to begin operations in the second quarter of calendar 2007. Recent regulatory changes concerning the trading of securities under Regulation NMS issued by the SEC and related actions are affecting how Edwards and other broker-dealers handle transactions. The Chairman and the Director of the Division of Investment Management of the SEC have stated that the SEC will be reviewing the fees paid by mutual fund companies to broker dealers and other entities under rule 12b-1 of the Securities and Exchange Act of 1934. Edwards receives significant payments of 12b-1 fees and changes in the rule governing such fees could have a material adverse affect on the receipt of such payments by Edwards. The United States Court of Appeals for the District of Columbia Circuit in March 2007 invalidated a final rule adopted by the SEC that exempted broker-dealers including Edwards from the requirements of the Investment Advisers Act in connection with certain activities and accounts. As a result of this ruling Edwards has stopped opening new fee-based brokerage accounts known as Client Choice and is reviewing the status of existing accounts and other business activities. The impact of this court ruling cannot be determined with certainty but, unless changed, will affect how brokerage activities are performed by Edwards and other broker-dealers.

As with most other publicly held companies, the Company was subject to the ongoing implementation of the Sarbanes-Oxley Act of 2002, particularly as it pertained to internal control over financial reporting. (See the Controls and Procedures section, Part II, Item 9A, for a detailed discussion of the Company's report on internal control over financial reporting).

#### *Company Performance Summary*

Overall for 2007, the Company set a record for annual net revenues at \$3.1 billion and experienced its fourth consecutive year of increased net revenues. The Company also posted its fifth consecutive year of increased net earnings, earnings per diluted share, pre-tax profit margin and return on average equity:

Additionally, results for 2006 have been adjusted to reflect a change in accounting method related to stock options and restricted stock (collectively referred to as "Stock Awards") granted to retirement-eligible employees under Statement of Financial Accounting Standards No. 123 (Revised 2004) "Share Based Payment" (SFAS No. 123R).

In reviewing its results for 2007, the Company's asset-management and service-fee revenues for the second consecutive year accounted for the largest percentage of net revenues, at 41 percent in 2007 and 39 percent last year. Higher client-asset levels in fee-based programs, mutual funds and other individual investments helped this revenue line grow to \$1.3 billion, a 19 percent increase for the year. The Company continues to believe this trend reflects a natural migration by clients toward fee-based programs and services to diversify their portfolios. In response to this client demand, the Company continues to expand its lineup of fee-based programs and services, including additional portfolio choices in its fund advisory programs and the introduction of its Unified Managed Portfolios, a program that allows investments in mutual funds and exchange traded funds and by professional money managers.

Helped by asset-management and service-fee revenue, net revenues for 2007 increased \$370 million (14 percent) as the Company posted increases in every major revenue category. Of note, the \$55 million (24 percent) increase in investment banking revenues largely reflected a significant increase in underwriting volume of closed-end funds and equity offerings. Additionally, the \$45 million (26 percent) increase in net interest revenues reflected an increased prime rate resulting in higher interest rates charged on margin balances, higher interest rates earned on the fixed-income inventory held for sale to clients and higher balances and rates earned on short-term investments partially offset by decreased margin loan balances.

During 2007, total client assets grew more than \$31 billion (9 percent), while client assets in fee-based accounts grew \$7 billion (18 percent).

The Company's results for 2007 included \$23 million in revenue for gains related to the merger of the NYSE and Archipelago Holdings, Inc. to form NYSE Group, Inc. ("NYSE Group"), including the mark-to-market on NYSE Group shares the Company currently holds. The results also included \$18 million in revenue for gains on the sales of shares in the Intercontinental Exchange ("ICE") and Chicago Mercantile Exchange ("CME") and the mark-to-market on the ICE, CME and New York Mercantile Exchange ("NYMEX") shares the Company currently holds.

Non-interest expenses for 2007 increased, albeit at a slower pace than revenue growth. Expenses for compensation and benefits in 2007 increased mainly due to greater revenue produced by the Company's financial consultants, earnings allocated to the Company's incentive compensation and a change in the expense recognition for employee awards of restricted stock and stock options. Communication and technology expenses also increased, largely because of higher depreciation expenses, higher technology-consulting expenses and higher securities-processing costs, which are consistent with greater client activity. The securities-processing costs became more variable in nature after the Company moved its securities-processing operations to an application service provider last year. As a partial offset, other expenses declined during the period as a result of lower expenses for addressing various regulatory changes and legal matters.

When comparing the Company's results for 2007 to those for 2006:

- Net earnings** □ Increased \$105 million (47 percent) to \$331 million.
- Diluted earnings per share** □ Increased \$1.41 (48 percent) to \$4.34.
- Net revenues** □ Increased \$370 million (14 percent) to \$3.1 billion.
- Pre-tax profit margin** □ Increased from 12.4 percent to 16.7 percent.

When comparing the Company's results for 2006\* to those for 2005:

- Net earnings** □ Increased \$40 million (21 percent) to \$226 million.
- Diluted earnings per share** □ Increased \$0.56 (24 percent) to \$2.93.

**Net revenues** □ Increased \$132 million (5 percent) to \$2.7 billion.

**Pre-tax profit margin** □ Increased from 11.3 percent to 12.4 percent.

\*Fiscal 2006 amounts have been adjusted due to a change in accounting method. See Note 2 (Employee Stock Plans) of the Notes to the Consolidated Financial Statements for a detailed discussion of the Company's Stock-Based Compensation plan.

The results for 2006 included \$5 million in revenue for gains on the sale of shares in the Chicago Board of Trade (□CBOT□), \$8 million in gains on CME shares, and a \$3 million gain on the sale of real estate. The 2006 results also reflected \$6 million in tax benefits resulting from the resolution of certain tax matters, including \$3 million in tax benefits from the resolution of tax matters related to technology research and development tax credits.

As a result of the Company's March 1, 2005 early adoption of SFAS No. 123R, the Company recognized in the first quarter of 2006 a one-time, \$3 million after-tax benefit, as the cumulative effect of a change in accounting method, resulting from the requirement to estimate forfeitures of restricted stock awards at the date of grant instead of recognizing them as incurred. Based on interpretive guidance related to SFAS No. 123R, the Company changed its accounting method such that compensation expense only for Stock Awards to retirement-eligible employees was retroactively recorded in 2006, in accordance with Statement of Financial Accounting Standards No. 154 □Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3□ (□SFAS No. 154□). Stock Awards to non-retirement eligible employees for 2006 granted in the first quarter of 2007 are being expensed over their service period, generally three years.

In both the 2007 versus 2006 and the 2006 versus 2005 comparisons, the Company experienced a general increase in net revenues paced by record results in asset-management and service-fee revenues, combined with higher compensation expenses based on higher commissionable revenue and the Company's increased profitability. A detailed discussion of the Company's results of operations follows.

## Results of Operations

The Company generates revenues primarily through Edwards. These revenues can be categorized into six main components: asset-management and service fees, commissions, principal transactions, investment banking, net interest revenue and other.

Many factors affect the Company's net revenues and profitability, including economic and market conditions, the level and volatility of interest rates, inflation, political events, investor sentiment, legislative and regulatory developments, and competition. Because many of these factors are unpredictable and beyond the Company's control, earnings may fluctuate significantly from year to year.

The following table illustrates the composition of the Company's net revenues for 2007, 2006 and 2005:

|                                   | 2007 | 2006 | 2005 |
|-----------------------------------|------|------|------|
| Asset management and service fees | 41%  | 39%  | 35%  |
| Commissions                       | 33%  | 37%  | 40%  |
| Principal transactions            | 7%   | 8%   | 10%  |
| Investment banking                | 9%   | 9%   | 9%   |
| Net interest                      | 7%   | 6%   | 5%   |
| Other                             | 3%   | 1%   | 1%   |

Following are descriptions of the Company's revenue and expense components and its operational results in each:

### Asset Management and Service Fees

Revenues from asset-management services are based principally on the amount of certain client assets held through the Company. These assets may be managed by the Company, by Gallatin Asset Management, Inc. (Gallatin) or by third-party investment managers, including third-party portfolio managers, mutual funds, managed futures funds, money market funds, annuities and insurance companies. The Company manages certain client assets through the A.G. Edwards Trust Company FSB (Trust Company), a wholly owned subsidiary and

federally chartered savings bank that provides portfolio management and trust services. In addition, the Company offers a non-discretionary advisory program known as Portfolio Advisor and a discretionary advisory program known as FC Advisor.

The Company also offers fee-based fund advisory programs that allow clients to select from recommended, established asset allocation models or customize their own models in certain programs. The fund advisory programs are known individually as AGE Allocation Advisors, AGE Pathways and AGE Professional Fund Advisor.

Gallatin provides separately managed accounts and other services to Edwards and markets its investment-management services to unaffiliated mutual-fund firms, pension-fund providers, insurance companies and other financial institutions, including banks and brokerage firms. Gallatin receives management fees for its services.

Asset-management and service-fee revenues for 2007 increased \$203 million (19 percent) to post an annual record of \$1.3 billion. Growth in this revenue category was helped by the Company's fee-based programs, which increased \$88 million (23 percent) due in part to an 18 percent increase in the number of client accounts in these programs under third-party management or through the Company's fee-based transaction accounts and trust services.

Fees received from third-party mutual funds, managed futures and insurance providers increased \$113 million (20 percent) mainly as a result of increased asset values in these investment products. Service-fee revenues increased \$3 million (2 percent) due in part to an increase by Edwards in the postage and handling fee on certain transactions.

Asset-management and service-fee revenues displayed modest volatility throughout the year but generally maintained an upward bias as it established a new annual record. The Company's fund advisory programs again displayed the greatest strength among the Company's fee-based programs, both in terms of client-asset growth (45 percent) and client-account growth (38 percent).

Client assets in fee-based accounts increased \$7 billion (18 percent) from February 28, 2006 to February 28, 2007 and increased \$7 billion (22 percent) from February 28, 2005 to February 28, 2006. An analysis of changes in assets in fee-based accounts from these time periods is detailed below (dollars in millions):

|                                                 | February<br>28,<br>2007 | February<br>28,<br>2006 | 2007 vs.<br>2006 | February<br>28,<br>2005 | 2006<br>vs.<br>2005 |
|-------------------------------------------------|-------------------------|-------------------------|------------------|-------------------------|---------------------|
| <b>Assets in fee-based accounts</b>             |                         |                         |                  |                         |                     |
| Fund advisory programs                          | \$20,393                | \$14,059                | 45%              | \$ 9,871                | 42%                 |
| Separately managed accounts                     | 12,853                  | 12,030                  | 7%               | 11,438                  | 5%                  |
| Company-managed and<br>other fee-based accounts | 10,922                  | 11,357                  | (4)%             | 9,443                   | 20%                 |
| Total assets in fee-based accounts              | \$44,168                | \$37,446                | 18%              | \$30,752                | 22%                 |

In mid-February 2007, the Company introduced its bank deposit program (AGE Bank Deposit Program) to certain clients as part of a multi-stage rollout to all eligible clients. The AGE Bank Deposit Program offers up to \$1 million in FDIC insurance, competitive interest rates and the opportunity to earn higher interest rates based

on household asset values and account type. Also in 2007, the Trust Company received approval from the Office of Thrift Supervision ( OTS ) to expand its powers to be able to accept time and demand deposits so it can participate, along with several other FDIC-insured banks, in the AGE Bank Deposit Program. The Company expects the Trust Company to begin accepting client deposits in the second quarter of 2008.

The revenue contribution of the AGE Bank Deposit Program was not material to the Company's 2007 results of operations. The revenue impact of this program in 2008 cannot be determined with certainty and will depend, among other things, on the amount of assets that clients move into the AGE Bank Deposit Program, when the Trust Company begins accepting deposits, the amount of deposits placed with the Trust Company, the amount of new assets brought to the Company as a result of this program, and competitive and economic factors. As of April 25, 2007, the Company had average money fund balances of \$20 billion that are eligible for conversion to this program.

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Revenue and expenses derived from deposits placed with the Trust Company through the AGE Bank Deposit Program will be reflected in net interest revenue in future periods. Revenue and expenses derived from assets deposited in other FDIC-insured banks through this program will be reflected in asset-management and service fees in future periods.

In 2006 asset-management and service-fee revenues increased \$144 million (16 percent). The growth was driven by a \$63 million (19 percent) increase in revenue from the Company's fee-based programs, generated in part by a 22 percent increase in the number of client accounts in these programs under third-party management or through the Company's fee-based transaction accounts and trust services.

Fees received from third-party mutual funds, managed futures and insurance providers increased \$78 million (21 percent) mainly as a result of increased asset values in these investment products. Service-fee revenues increased \$7 million (8 percent) due to greater revenue from the Company's asset accounts and investment-research services. These results were partially offset by a \$4 million (3 percent) decline in fees received from the distribution of certain money funds, due mainly to a decrease in client assets in those money funds.

### **Commissions**

The Company generates commission revenues when acting as an agent for client activities in transaction-based accounts in listed and over-the-counter securities, mutual funds, insurance products, futures and options. These revenues can be affected by trading volumes, by the dollar value of individual transactions, by market and economic conditions, and by investor sentiment because the Company's clients are primarily retail-oriented.

Commission revenues increased \$14 million (1 percent) in 2007 compared to 2006. Commissions from equity transactions increased \$9 million (2 percent), revenues from transactions in insurance products increased \$5 million (3 percent) and commissions from individual mutual-fund transactions were essentially flat. As a partial offset to these increases, commission revenues from commodities and financial futures decreased \$1 million (5 percent) and commission revenues from options transactions decreased \$1 million (2 percent).

Commission revenues from equity transactions were at or near their best performance in May, while they displayed their weakest performance in July, consistent with market declines and seasonally slower activity. The Company benefited modestly from a change in its commission schedule for equity and options transactions, which went into effect March 15, 2006. Commission revenues from individual mutual-fund and insurance-product transactions were strongest in the first and fourth quarters of 2007. The Company believes the essentially flat revenue contribution from individual mutual-fund transactions was partly attributable to the continued client migration toward fee-based fund advisory programs.

Commission revenues for 2006 declined \$16 million (2 percent) from 2005. While commissions from listed-stock transactions increased \$9 million (2 percent), commissions in over-the-counter equities declined \$13 million (14 percent). Meanwhile, commissions from transactions in mutual funds declined \$16 million (6 percent) and commissions from commodities and financial futures decreased \$1 million (4 percent). These declines were



partially offset by a \$2 million (7 percent) increase in revenues from options transactions and a \$3 million (2 percent) increase in transaction revenues from insurance products.

The 2006 commission revenues generally reflected increased client activity in equities and mutual funds when major market indexes reached various peaks. Revenues from insurance products were generally steady throughout 2006 as clients sought these products to help diversify their portfolios. Additionally, the strong pace of asset growth in fee-based programs suggested greater client interest in these programs versus individual transactions.

### **Principal Transactions**

The Company maintains inventories of fixed-income and equity securities to satisfy client demand and, therefore, effects certain transactions with its clients by acting as a principal. Realized and unrealized gains and losses result from the sale and holding of securities positions for resale to clients and are included in principal-transaction revenues.

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In 2007 principal-transaction revenues increased \$5 million (2 percent) versus 2006. A \$9 million (11 percent) revenue increase from transactions in equity securities held in the Company's inventory overcame decreases of \$2 million (6 percent) in revenues from corporate-debt transactions and \$2 million (3 percent) in revenues from municipal-debt transactions. Revenue from government-debt transactions was essentially flat.

Client activity in over-the-counter equity securities was generally consistent with equity activity noted above in Commission revenues. Conversely, client activity in municipal- and government-debt securities was strongest in the periods of weakness for the equity markets as clients took more defensive positions in their portfolios.

In 2006 principal-transaction revenues decreased \$44 million (17 percent) versus 2005. The overall decline in this revenue category was driven almost entirely by a slowdown in client activity in the fixed-income markets, as evidenced by a \$17 million (19 percent) decrease in revenue from municipal-bond transactions, a \$17 million (39 percent) decrease in corporate-debt transactions and a \$13 million (29 percent) decrease in revenue from government-debt transactions. These decreases were partially offset by \$3 million (4 percent) increase in revenues from transactions in equity securities held in the Company's inventory. Investor concerns about interest rates and improving equity markets were the main factors affecting activity in this revenue category during 2006.

### **Investment Banking**

Investment banking revenues result primarily from bringing new issues of securities, both equity-based and fixed income-based, to the market for issuers. The issuers are generally corporate or municipal clients but may be institutional clients of Edwards in the case of exchange-traded funds and related products. Investment banking revenues vary depending on the number and size of transactions successfully completed and generally are received in the form of underwriting fees or selling concessions. Additionally, the Company receives fees for financial advisory services, including advice on mergers and acquisitions, restructurings, and other strategic advisory needs.

Investment banking revenues in 2007 increased \$55 million (24 percent), posting their second-best annual performance and their best-ever quarterly performance in the fourth quarter. Underwriting fees and selling concessions from equity products increased \$26 million (21 percent). Underwriting fees and selling concessions from corporate-debt products increased \$4 million (18 percent). These increases were partially offset by a \$3 million (12 percent) decrease in underwriting fees and selling concessions from municipal- and government-debt products.

The Company participated in a significantly greater volume of equity underwritings during 2007, particularly in the area of closed-end funds as several large issues came to market. Related management fees from these underwritings accounted for much of the overall increase in management fees. The Company also had a greater volume of underwritings in its core focus areas of energy, financial and real estate. The increase in corporate-debt activity was primarily due to increased client demand for preferred-debt issues. The revenue decrease from municipal underwritings was mainly due to greatly reduced volume from municipalities issuing

new debt or refinancing existing debt.

In 2006 investment banking revenues decreased \$11 million (5 percent). While underwriting fees and selling concessions from corporate-equity products were essentially flat for the year, underwriting fees and selling concessions from corporate-debt products decreased \$7 million (23 percent) and government-debt products decreased \$4 million (66 percent). Management fees in 2006 decreased \$6 million (8 percent). These results were partially offset by a \$5 million (28 percent) increase in underwriting fees and selling concessions from municipal-debt products. The underwriting environment in 2006 was largely the opposite experienced in 2007, as the Company had a significantly lower volume of closed-end-fund underwriting partially offset by a greater volume of municipal underwritings as municipalities took advantage of the interest-rate environment.

### **Net Interest Revenue**

Interest revenue is derived primarily from financing clients' margin transactions. These revenues are based largely on the amount of client margin balances and the rate of interest charged on these balances. The Company also earns revenue from interest and dividend payments on inventory held for sale to clients and from short-term investments.

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Interest revenue net of interest expense increased \$45 million (26 percent) in 2007. A 2 percent increase in the prime rate — the base rate the Company uses for charging interest on average margin balances — was primarily responsible for the \$8 million (6 percent) increase in revenue from margin balances. During the year, average client margin balances declined from \$1.9 billion to \$1.6 billion. The decline in these balances is believed to be, in part, the by-product of more client assets moving to fee-based programs, most of which do not allow clients to have margin accounts. Higher interest rates also were the primary driver behind a \$25 million (153 percent) increase in revenue from the Company's short-term investments. Higher interest rates from fixed-income securities and dividend payments from equity securities held in inventory contributed to a \$17 million (65 percent) revenue increase from this inventory.

As noted earlier, net interest revenue in future periods will reflect the impact of client assets deposited in the Trust Company through the AGE Bank Deposit Program.

The following chart details the average client margin balances as of February 28(29) 2004, 2005, 2006 and 2007 and the average rate charged on those balances:

Interest revenue net of interest expense increased \$46 million (37 percent) in 2006 for mainly the same reasons as those noted above for the 2007 results. Average client margin balances during 2006 declined from \$2.1 billion to \$1.9 billion.

### **Other Revenue**

Other revenue is derived primarily from the Company's investment activities in equity and equity-related securities along with four Company-sponsored private equity partnerships.

Other revenue increased \$47 million (107 percent) in 2007. These results included \$23 million in revenue for gains related to the merger of the NYSE and Archipelago Holdings, Inc. to form NYSE Group, including the mark-to-market on NYSE Group shares the Company currently holds. The results also included \$14 million in revenue for gains on the sale of shares in ICE and the mark-to-market on the ICE and NYMEX shares the Company currently holds. Additionally, the results in other revenue reflected a \$21 million increase in gains in 2007 versus 2006 on the Company's private-equity investment valuations and dividend payments. The increase was partially offset by a \$3 million decrease in gains the Company recorded in 2007 versus 2006 for the sale of shares in the CME and the mark-to-market on other CME shares the Company currently holds. The 2006 and 2007 sales of CME shares occurred after shareholding requirements for CME membership were lowered. The 2007 sale of ICE shares occurred after the merger of ICE and New York Board of Trade (["NYBOT"]) in January 2007.

In 2006 other revenue increased \$14 million (46 percent). The 2006 results included a \$5 million gain on the sale of shares in the CBOT that the Company was not required to own for CBOT membership. The increase also included a \$3 million gain on the sale of real estate and a \$13 million increase in revenue from the Company's private-equity investment valuations and dividend payments. The increase was partially offset by a \$2 million decrease in gains the Company recorded in 2006 versus 2005 for the sale of shares in the CME and the mark-to-market on other CME shares the Company currently holds. Both the 2005 and 2006 sales of CME shares occurred after the CME lowered shareholding requirements for CME membership.

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## Expenses

The Company's expenses are categorized into six components: compensation and benefits, communication and technology, occupancy and equipment, marketing and business development, floor brokerage, and other expenses.

### Compensation and Benefits

Compensation and benefits expenses comprise the largest components of the Company's overall expenses. Most of these expenses are variable in nature and relate to commissions paid to the Company's financial consultants for transaction-based or asset-management services and to incentive compensation, which is largely based on the profitability of the Company. This expense category also includes employee healthcare insurance costs.

For 2007, compensation and benefits increased \$171 million (10 percent). Commission expense increased \$55 million (7 percent). Incentive compensation increased \$103 million (32 percent), which included \$13 million in amortization expense related to stock awards for non-retirement eligible employees and \$7 million in accrued expense for Stock Awards to be granted to retirement-eligible employees. Retirement-eligible employees generally are those age 55 and older. See Note 2 (Employee Stock Plans) of the Notes to Consolidated Financial Statements for further discussion of the recent change of accounting method for retirement-eligible employees. Administrative salaries increased \$5 million (1 percent), and costs related to healthcare insurance and other benefits increased \$13 million (8 percent).

The increase in commission expense was primarily the result of higher commissionable revenue from fee-based programs and individual transactions, partially offset by adjustments Edwards made to the compensation of its financial consultants effective April 3, 2006, lowering the commission payout schedule to its financial consultants on certain transactions. The increase in incentive compensation was due mainly to the Company's 47 percent increase in net earnings during 2007 and an increase in the number of financial consultants qualifying for sales bonuses. The increase in administrative salaries largely reflected general salary increases. The increase in healthcare insurance costs was mainly a reflection of generally higher individual claims during the year.

For 2006, compensation and benefits expenses increased \$62 million (4 percent). Commission expense increased \$11 million (1 percent) and incentive compensation increased \$4 million (1 percent), both due to increased sales and earnings. Administrative salaries increased \$6 million (2 percent) as a result of general salary increases and a net increase in salaried employees. Healthcare insurance costs increased \$5 million (9 percent) due to higher individual claims.

As a partial offset to other incentive-compensation expenses, the Company's early adoption of SFAS No. 123R additionally resulted in an expense for Stock Awards only for non-retirement eligible employees being recognized in 2006. Stock awards granted at the end of 2006 for non-retirement eligible employees are being expensed over their service period, generally three years, which began in 2007. See Note 2 (Employee Stock Plans) of the Notes to Consolidated Financial Statements for further discussion of the impact of the Company's change in accounting method for Stock Awards to retirement-eligible employees.

Upon the adoption of SFAS No. 123R, the Company recognized the compensation expense related to Stock Awards to retirement-eligible employees on the date of grant. Based on interpretive guidance related to SFAS No. 123R, on March 1, 2006, the Company changed its accounting method for recognizing the cost of Stock Awards

that are granted to retirement-eligible employees. The Company is accruing an expense throughout the fiscal year preceding the date of grant representing an estimate of Stock Awards to be granted to retirement-eligible employees as a result of such fiscal year's service rather than recognize the expense on grant date, which occurs in the first quarter of the subsequent fiscal year. The accounting for Stock Awards to non-retirement eligible employees did not change and will be recognized over the service period, generally three years from grant date. Following is a table that outlines the actual/projected expense impact for non-retirement eligible employees Stock Awards for the fiscal years 2007 through 2010:

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### Actual/Projected Expense Impact of Non-Retirement Eligible Employees Stock Awards

| For Non-Retirement Eligible Employees Stock Awards Granted For:    | 2007                | 2008                | 2009                                                      | 2010                                                               |
|--------------------------------------------------------------------|---------------------|---------------------|-----------------------------------------------------------|--------------------------------------------------------------------|
|                                                                    | Expense Impact      | Expense Impact      | Expense Impact                                            | Expense Impact                                                     |
| 2006                                                               | \$13 million        | \$11 million        | \$10 million                                              | \$ 2 million                                                       |
| 2007                                                               | □                   | \$15 million        | \$14 million                                              | \$13 million                                                       |
| <b>Total Actual/Projected</b>                                      | <b>\$13 million</b> | <b>\$26 million</b> | <b>\$24 million</b>                                       | <b>\$15 million</b>                                                |
| <b>Expenses For Non-Retirement Eligible Employees Stock Awards</b> |                     |                     | plus expense for Stock Awards to be granted in April 2008 | plus expense for Stock Awards to be granted in April 2008 and 2009 |

Differences between the projected and actual expenses for non-retirement eligible employees Stock Awards for 2008 and subsequent fiscal years may occur as a result of actual employee forfeitures of non-retirement eligible employees Stock Awards compared to the Company's estimates and/or future accounting pronouncements by the Financial Accounting Standards Board (FASB), SEC or other regulatory authority.

### Communication and Technology

Communication and technology expenses mainly encompass those costs associated with operating the Company's back-office systems and technology infrastructure, which includes computer software and hardware and the amortization and depreciation of each along with data and trade processing. This expense line also includes costs for contract workers assigned to the Company's various technology projects and needs. Additionally, account-statement printing and mailing, telephone service and technology repairs and maintenance all fall under this expense category.

Communication and technology expenses increased \$21 million (9 percent) in 2007. Professional expenses for outside consultants increased by \$17 million (93 percent) due to various projects, including the Company's transition from certain legacy back-office systems. Amortization and depreciation expenses increased \$5 million (7 percent) as a result of several new technology projects. Expenses associated with the conversion of securities-processing operations to an application service provider increased \$4 million (35 percent) due in part to greater client activity. As partial offsets, expenses related to repairs and maintenance decreased \$2 million (14 percent) and expenses for certain telecommunications services decreased \$3 million (15 percent).

In 2006 communication and technology expenses declined \$5 million (2 percent) as the Company completed several significant projects, resulting in decreased professional expenses for outside consultants. Amortization and depreciation expenses also decreased as several assets became fully depreciated. Partially offsetting these decreases were increases from securities-processing expenses associated with the conversion of securities-processing operations to an application service provider and data-processing expenses associated with data-processing services provided by an outside service provider.

### Occupancy and Equipment

Occupancy and equipment expenses relate mainly to the leases for the Company's branch-office locations and the amortization and depreciation expenses associated with equipment and furniture in those locations.

In 2007 occupancy and equipment expenses increased \$6 million (4 percent) primarily due to higher rates associated with renewing certain branch-office leases.

In 2006, occupancy and equipment expenses decreased \$7 million (5 percent). The decrease was primarily due to a \$10 million charge recorded in 2005 to correct the recognition period for rent-escalation clauses and lease incentive in certain branch-office leases. The decrease was partially offset by increases in amortization expenses for leasehold improvements.

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## **Marketing and Business Development**

Marketing and business development expenses are mainly related to the Company's branding initiative, local-branch advertising and promotional efforts, and travel and entertainment expenses.

In 2007 marketing and business development expenses increased \$5 million (7 percent). Expenses associated with the Company's national sales conference largely accounted for a \$6 million (54 percent) increase in travel expenses. Partially offsetting this increase was \$2 million (4 percent) in decreased costs associated with the Company's branding initiative and other business-promotion expenses primarily resulting from timing differences in advertising schedules.

While the amount for 2008 has not been determined with certainty, the Company expects its branding initiative to cost approximately \$20 million, with fluctuations from period to period.

In 2006 marketing and business development expenses increased \$6 million (9 percent) primarily due to an increase in advertising expenses associated with the Company's branding initiative and other business-promotion expenses.

## **All Other Expenses**

All remaining operational expenses are largely related to professional expenses for legal, regulatory and audit consulting services, reserves and settlements for legal and regulatory matters, licensing and registration fees, publication and subscription expenses, and floor brokerage expenses.

In 2007 all remaining operational expenses decreased \$13 million (7 percent), led by an \$11 million (20 percent) decline in professional expenses for legal and regulatory consulting services. Reserves and settlements for various legal and regulatory matters were \$3 million (8 percent) lower than the prior year. A \$2 million (9 percent) decrease in floor brokerage and clearance expenses resulted from lower fees charged by various securities exchanges. As a partial offset, the Company had a \$3 million (15 percent) increase in expenses related to certain media-vendor services.

In 2006 all remaining operational expenses increased \$31 million (20 percent) due largely to increases in reserves and settlements for various legal and regulatory matters, professional expenses for legal and regulatory consulting services, and an increase in registration fees due mainly to an \$8 million credit recorded in 2005 to correctly recognize state registration fees for the Company's financial consultants over the registration period.

## **Income Taxes**

The Company's effective tax rate was 36.4 percent for 2007 compared with 34.5 percent for 2006. The increase in the effective tax rate was due largely to the recognition of \$6 million in tax benefits from the resolution of certain tax matters during 2006, including \$3 million in tax benefits from the resolution of tax matters related to technology research and development tax credits.

**Impact of Stock Exchange Holdings**

On March 7, 2006, the NYSE and Archipelago Holdings, Inc. closed a merger agreement and formed a new holding company, NYSE Group. In the merger, NYSE members were entitled, and the Company elected, to receive \$404,640 and 78,601 shares of NYSE Group common stock for each NYSE membership seat. The sale of shares are subject to certain restrictions that expire ratably over a three-year period, unless the NYSE Group board of directors removes or reduces the transfer restrictions earlier. The NYSE Group board of directors authorized a secondary distribution, and the Company sold 67,841 shares in the offering, at a price of \$60.27 per share in May 2006. In addition, Edwards purchases trading licenses through a modified Dutch auction process every year in order to receive the right to trade securities on the floor of the exchange. In January 2007, Edwards purchased four NYSE trading licenses at a price of \$50,000 each.

At February 28, 2006, Edwards had four NYSE membership seats included in other assets on the consolidated balance sheet at a total cost of \$492,000. Factoring in the Company's cost basis for the four seats and the transfer restrictions on the remaining shares, the Company recorded a \$23 million gain related to the merger. Subsequent gains or losses will be recorded in future periods as transfer restrictions expire and the share price of NYSE Group stock fluctuates. As of February 28, 2007, the Company owned 246,563 NYSE Group shares.

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Edwards currently has two NYMEX membership seats included in other assets at a cost of \$10,000. In addition, Edwards owns 196,800 shares of NYMEX common stock, of which 150,000 are required membership holdings and 46,800 are subject to transfer restrictions. Factoring in the Company's cost basis for the two seats and the transfer restrictions on the remaining shares, the Company recorded a \$6 million unrealized gain on the mark to market of the common stock as of February 28, 2007.

Edwards currently has six NYBOT membership seats included in other assets at a cost of \$243,000. In January 2007, the NYBOT and the ICE closed a merger agreement that resulted in the issuance of ICE common stock to existing NYBOT membership seat holders. As a result of the merger, Edwards received 66,404 shares of ICE common stock, of which 27,402 shares are required membership holdings and 7,905 shares were available for sale. Edwards sold 31,097 shares during the current year. Factoring in the Company's cost basis for the six seats and the sales proceeds, the Company recorded an \$8 million gain related to the merger and subsequent sale of ICE common stock.

Edwards currently has three CME membership seats included in other assets at a cost of \$9,000. As of February 28, 2007, Edwards owned 12,666 shares of CME common stock, of which 8,000 shares were required membership holdings. Edwards sold 2,334 common shares in February 2007. The Company recorded \$7 million gain for the sale of stock and a \$3 million gain for the mark to market of remaining available for sale shares.

Edwards currently has two CBOT membership seats included in other assets at a cost of \$31,000. As of February 28, 2007, Edwards owned 54,676 shares of CBOT common stock, all of which are required membership holdings. The book value of both the CBOT seats and shares are held at cost, and no gain was recognized in the current year.

As a result of the changes noted above at various securities exchanges of which the Company is a member, has trading privileges or has access to, portions of the Company's shareholdings in these exchanges will impact the Company's results of operations. Subsequent gains or losses will be recorded in future periods as transfer restrictions expire, as the share prices of these stocks fluctuate, and if any or all of these exchanges change shareholding requirements for membership. Shares required for exchange membership do not impact results of operations and are included in other assets on the consolidated balance sheet.

Following is a table that illustrates the exchanges in which the Company owned shares:

| <b>Securities Exchange</b> | <b>Shares<br/>Impacting<br/>Results of<br/>Operations</b> | <b>Shares<br/>Required<br/>for<br/>Exchange<br/>Membership</b> |
|----------------------------|-----------------------------------------------------------|----------------------------------------------------------------|
|                            |                                                           |                                                                |

|                  |            |         | <b>Total Shares<br/>Held</b> |
|------------------|------------|---------|------------------------------|
| NYSE Euronext(2) | 246,563(1) | □       | 246,563                      |
| NYMEX            | 46,800(1)  | 150,000 | 196,800                      |
| ICE              | 7,905      | 27,402  | 35,307                       |
| CME              | 4,666(1)   | 8,000   | 12,666                       |
| CBOT             |            | 54,676  | 54,676                       |
| Other exchanges  | 1,100      |         | 1,100                        |

(1) Includes certain sales restrictions as set forth by the various exchanges.

(2) NYSE Group, Inc. and Euronext N.V. merged to create NYSE Euronext on April 4, 2007.

### **Impact of Change in Accounting Principle for Stock Awards to Retirement Eligible Employees**

Effective March 1, 2006, the Company changed its accounting for restricted-stock and stock-options awards (collectively referred to as the "Stock Awards") granted to retirement-eligible employees from expense recognition on grant date to expense recognition over the fiscal-year the Stock Awards are earned. As a result of this accounting change in 2007, the Company accrued an expense throughout the fiscal year for Stock Awards granted to retirement-eligible employees as a result of service during the fiscal year rather than recognize the expense on grant date, which occurred in April 2008. The accounting for awards to non-retirement eligible employees did not change and continues to be recognized over the service period, generally three years from grant date.

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Due to this change in the Company's accounting method, Stock Awards to retirement-eligible employees for 2006 totaling \$20 million were accounted for in accordance with SFAS No. 154. This amount, net of taxes, was retrospectively applied to 2006 financial statements, including interim financial statements. In 2007, an adjustment was made to the opening balances as if the change in accounting for Stock Awards to retirement-eligible employees had been in effect in prior periods. The result was that the opening balance of retained earnings were reduced by the amount of the Stock Awards, net of taxes, for retirement-eligible employees for 2006.

Employees, including retirement-eligible employees, were granted 1,030,024 restricted shares with a market value of approximately \$53 million, and 308,170 options on April 17, 2006.

### **Litigation and Regulatory Matters**

The Company is a defendant in a number of lawsuits, in some of which plaintiffs claim substantial amounts, relating primarily to its securities and commodities business. Management has determined that it is likely that ultimate resolution in favor of the plaintiffs will result in losses to the Company on certain of these claims and as a result, establishes accruals for potential litigation losses. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in adverse judgments, fines or penalties. Factors considered by management in estimating the Company's reserves for these matters are the loss and damages sought by the plaintiffs, the merits of the claims, the total cost of defending the litigation, the likelihood of a successful defense against the claims, and the potential for fines and penalties from regulatory agencies. The Company establishes reserves for potential losses to the extent that such matters are probable and can be estimated, in accordance with Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies." As litigation and the resolution of regulatory matters are inherently unpredictable, the Company cannot predict with certainty the ultimate loss or range of loss related to matters where there is only a reasonable possibility that a loss may be incurred. The Company believes, based on current knowledge and after consultation with legal counsel, that the resolution of loss contingencies will not have a material adverse effect on the consolidated balance sheet, statement of earnings or statement of cash flows of the Company. However, the outcome of such matters could be material to the Company's operating results and cash flows for future or interim periods, depending, among other things, on the results of operations for these periods.

See Item 3. - Legal Proceedings for further discussion of legal and regulatory matters.

### Liquidity and Capital Resources

The Company's assets fluctuate in the normal course of business, primarily due to the timing of certain transactions. The Company monitors and evaluates the composition and size of its balance sheet. A substantial portion of the Company's total assets consist of short-term receivables mainly resulting from margin loans to clients, along with highly liquid marketable securities. The principal sources for financing the Company's business are stockholders' equity, cash generated from operations, short-term bank loans and securities-lending arrangements. The Company has no long-term debt. Average short-term bank loans of \$2 million and \$28 million and average securities-lending arrangements of \$179 million and \$144 million for the years ended February 28, 2007 and 2006, respectively, were primarily used to finance customer margin transactions.

The Trust Company has been authorized to begin accepting time and demand deposits by the OTS. The Trust Company plans to begin accepting demand deposits from the AGE Bank Deposit Program in mid-calendar 2007. For further discussion, see Asset Management and Service Fees. The Trust Company is required to maintain minimum capital amounts and ratios to be considered as "well-capitalized" under the OTS regulatory framework for prompt corrective action. These requirements are approximately 10 percent of deposits. The exact amount of additional capital to be required by the Trust Company is subject to uncertainty.

In November 2006, the Company's Board of Directors authorized the repurchase of 10,000,000 shares of the Company's outstanding stock during the period from January 1, 2007, through December 31, 2008. In November 2004, the Company's Board of Directors authorized the repurchase of up to 10,000,000 shares of the Company's outstanding stock during the period November 19, 2004, through December 31, 2006. There were 6,203,611 shares repurchased by the end of the expiration period for the November 19, 2004 authorization. In November 2002, the Company's Board of Directors authorized the repurchase of up to 10,000,000 shares of the Company's outstanding

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common stock during the period of January 1, 2003, through December 31, 2004. The January 1, 2003 authorization was fulfilled in its entirety. The Company purchased 3,241,865 shares at an aggregate cost of \$181 million in 2007, 3,204,769 shares at an aggregate cost of \$142 million in 2006 and 7,026,392 shares at an aggregate cost of \$250 million in 2005. At February 28, 2007, the Company had up to 9,419,832 shares available for repurchase under the January 2007 authorization.

In May 2005, the Company's Board of Directors authorized the repurchase of up to 5,000,000 shares of the Company's outstanding stock solely to effect employee stock transactions in the Company's Retirement and Profit Sharing Plan during the period May 24, 2005, through May 31, 2008. The Company purchased 332,437 shares at an aggregate cost of \$19 million during the year ended February 28, 2007. The Company purchased 153,021 shares at an aggregate cost of \$7 million during the year ended February 28, 2006. At February 28, 2007, the Company had up to 4,514,542 shares available for repurchase under this authorization.

In May 2005, the Company's Board of Directors authorized the sale of up to 5,000,000 shares of the Company's stock to the Company's Retirement and Profit Sharing Plan during the period May 24, 2005 through May 31, 2008. The Company sold 372,293 shares at aggregate proceeds of \$18 million in 2007. The Company sold 153,727 shares at aggregate proceeds of \$7 million during the year ended February 28, 2006. At February 28, 2007, the Company had 4,473,980 shares available to sell.

### Tabular Disclosure of Contractual Obligations

The following table summarizes information about the Company's long-term contractual commitments and obligations as of February 28, 2007 (dollars in thousands):

| Contractual Obligations     | Total      | 2008      | 2009-2010  | 2011-2012  | More than 5 years |
|-----------------------------|------------|-----------|------------|------------|-------------------|
| Operating lease obligations | \$ 470,600 | \$ 93,400 | \$ 156,000 | \$ 107,500 | \$ 113,700        |



|                                                              |            |            |            |            |            |
|--------------------------------------------------------------|------------|------------|------------|------------|------------|
| Communications, technology, and other<br>service commitments | 216,300    | 103,100    | 77,800     | 32,300     | 3,100      |
|                                                              | \$ 686,900 | \$ 196,500 | \$ 233,800 | \$ 139,800 | \$ 116,800 |

The Company had unfunded commitments of \$30 million to various private equity investments at February 28, 2007. These commitments are subject to calls by the partnerships, as funds are needed.

Management believes the Company has adequate sources of credit available, if needed, to finance customer-trading volumes, additional capital for the Trust Company, expansion of its branch system, stock repurchases, dividend payments and major capital expenditures. Currently the Company, with certain limitations, has access to \$1.2 billion in uncommitted lines of credit as well as the ability to increase its securities lending activities.

Edwards is required by the SEC to maintain specified amounts of liquid net capital to meet its obligations to clients. At February 28, 2007, Edwards' net capital of \$785 million was \$747 million in excess of the minimum requirement.

### Critical Accounting Policies

The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America. In preparing these consolidated financial statements, management makes use of certain estimates and assumptions. See Note 1 (Summary of Significant Accounting Policies) of the Notes to Consolidated Financial Statements. The Company believes that of its significant accounting policies, the following critical policies, estimates and assumptions may involve a higher degree of judgment and complexity and are the most susceptible to significant fluctuations in the near term.

#### *Valuation of Investments*

The fair value of investments, for which a quoted market or dealer price is not available, is based on management's estimate. Among the factors considered by management in determining the fair value of investments are cost, terms and liquidity of the investment, the sale price of recently issued securities, the financial condition and operating results of the issuer, earnings trends and consistency of operating cash flows, the long-term business potential of the issuer, the quoted market price of securities with similar quality and yields that are publicly traded,

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information as to any transactions or offers with respect to the security, existence of merger proposals or tender offers affecting the securities, and other factors generally pertinent to the valuation of investments. The Company holds investments that may have quoted market prices but that are subject to restrictions (e.g., consent of the issuer or other investors to sell) that may limit our ability to realize the quoted market price. Accordingly, the Company estimates the fair value of these securities based on management's best estimates, which incorporates pricing models based on projected cash flows, earnings multiples, comparisons based on similar transactions and/or review of underlying financial conditions and other market factors.

#### *Legal Reserves and Regulatory Matters*

The Company is a defendant in a number of lawsuits, in some of which plaintiffs claim substantial amounts, relating primarily to its securities and commodities business. Management has determined that it is likely that ultimate resolution in favor of the plaintiffs will result in losses to the Company on certain of these claims and as a result, establishes accruals for potential litigation losses. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in adverse judgments, fines or penalties. Factors considered by management in estimating the Company's reserves for these matters are the loss and damages sought by the plaintiffs, the merits of the claims, the total cost of defending the litigation, the likelihood of a successful defense against the claims, and the potential for fines and penalties from regulatory agencies. The Company establishes reserves for potential losses to the extent that such matters are probable and can be estimated, in accordance with Statement of Financial Accounting Standards No.

5, [Accounting for Contingencies.] As litigation and the resolution of regulatory matters are inherently unpredictable, the Company cannot predict with certainty the ultimate loss or range of loss related to matters where there is only a reasonable possibility that a loss may be incurred. The Company believes, based on current knowledge and after consultation with legal counsel, that the resolution of loss contingencies will not have a material adverse effect on the consolidated balance sheet, statement of earnings or statement of cash flows of the Company. However, the outcome of such matters could be material to the Company's operating results and cash flows for future or interim periods, depending, among other things, on the results of operations for these periods.

See [Item 3. - Legal Proceedings] for further discussion of legal and regulatory matters.

#### *Allowance for Doubtful Accounts From Customers*

Receivables from customers consist primarily of floating rate loans collateralized by margin securities. Management estimates an allowance for doubtful accounts to reserve for potential losses from unsecured and partially secured customer accounts deemed uncollectible. The facts and circumstances surrounding each receivable and the number of shares, price and volatility of the underlying collateral are considered by management in determining the allowance. Management continually evaluates its receivables from customers for collectibility and possible write-off. The Company manages the credit risk associated with its receivables from customers through credit limits and continuous monitoring of collateral.

#### *Income Taxes*

The Company operates in multiple taxing jurisdictions, and as a result, accruals for tax contingencies require management to make estimates and judgments with respect to the ultimate tax liability in any given year. Actual results could vary from these estimates. In management's opinion, adequate provisions for income taxes have been made for all years.

#### *Valuation of Stock Options*

The Company uses SFAS No. 123R to account for awards of equity instruments to employees. SFAS No. 123R requires measurement of the cost of employee services received in exchange for an award based on the fair value of the award on the grant date. The fair value of the stock options is estimated using expected dividend yields of the Company's stock, the expected volatility of the stock, the expected length of time the options remain outstanding, and risk-free interest rates. Changes in one or more of these factors may significantly affect the estimated fair value of the stock options. Additionally, SFAS No. 123R requires the Company to estimate the number of instruments for which the required service is expected to be rendered. The Company estimates forfeitures using historical forfeiture rates for previous grants of equity instruments.

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### **Recent Accounting Pronouncements**

In February 2007, the FASB issued SFAS No. 159, [The Fair Value Option for Financial Assets and Liabilities, including an amendment of FASB Statement No. 115] ([SFAS No. 159]). SFAS No. 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses shall be reported on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157 [Fair Value Measurements] ([SFAS No. 157]). The Company is currently assessing the impact that SFAS No. 159 will have on the consolidated financial statements.

In September 2006, FASB issued SFAS No. 158, [Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)] ([SFAS No. 158]). SFAS No. 158 requires employers to recognize the overfunded or underfunded status of a defined benefit post-retirement plan as an asset or liability in its statement of financial position. Further, this statement requires employers to recognize changes in the funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. The Company's adoption of SFAS No.

158 did not have a material impact on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157 which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. This statement applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact that SFAS No. 157 will have on the consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements" ("SAB 108"). SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB 108 requires an entity to quantify misstatements using a balance sheet and income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The Company's adoption of SAB No. 108 did not have a material impact on the consolidated financial statements.

In June 2006, FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt the provisions of FIN No. 48 beginning in the first quarter of 2008. The Company is currently evaluating the impact the adoption of FIN 48 may have on the consolidated financial statements.

In June 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" a replacement of APB Opinion No. 20 and FASB Statement No. 3, ("SFAS No. 154"). SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting method. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. The Company adopted SFAS No. 154 on March 1, 2006, and applied the pronouncement to its change in accounting method for stock awards granted to retirement-eligible employees.

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## **Risk Management**

### ***General***

Finding the proper balance of risk taking and risk mitigation, in a manner consistent with the Company's risk appetite, is critical to the success of the Company's financial stability and long-term profitability. The business activities of the Company expose it to a variety of risks, including operational, legal and regulatory, credit and market risk. Company management oversees the identification and assessment of the various risks and the development of appropriate risk mitigation activities, which primarily consist of internal controls, policies, and procedures. The execution of the risk mitigation activities is carried out at the business-unit level. The Company is in the early stages of developing an Enterprise Risk Management function to help coordinate and support firm-wide risk management efforts. Furthermore, the Internal Audit Department, reporting directly to the Audit Committee, provides independent assessments on the effectiveness of the risk management activities occurring throughout the Company. The following discussion highlights the principal risks faced by the Company and provides examples of how these risks are managed.

### ***Operational Risk***

Operational risk refers to the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. This includes, but is not limited to, business interruptions, improper or unauthorized execution and processing of transactions, deficiencies in the Company's operating systems, and inadequacies or breaches in the Company's control processes. The Company is reliant on the ability of its

employees, its internal systems, and the systems of its third-party vendors to process a large number of transactions. In the event of a breakdown or improper operation of the Company's or third-party's systems or improper actions by employees, the Company could suffer financial loss, regulatory sanctions and damage to its reputation.

In order to mitigate and control operational risk, the Company has developed, and continues to enhance, specific internal controls, policies and procedures that are designed to identify and manage operational risk at appropriate levels throughout the organization. The purpose of these mechanisms is to provide reasonable assurance that the Company's business operations are functioning within the policies and limits established by management. Additionally, business continuity plans have been developed for critical processes and systems so that the Company can sufficiently recover its critical operations should a business interruption occur.

### ***Legal and Regulatory Risk***

Legal and regulatory risk includes the risk of non-compliance with applicable legal and regulatory requirements, the risk of adverse legal judgments against the Company, and the risk that a counterparty's performance obligations will be unenforceable. The Company is subject to extensive regulation in the different jurisdictions in which it conducts its business, and this regulatory scrutiny has been significantly increasing over the last several years. The Company has established and continues to enhance procedures based on legal and regulatory requirements that are reasonably designed to ensure compliance with all applicable statutory and regulatory requirements. In connection with its business, the Company has various procedures addressing significant topics such as regulatory capital requirements, sales and trading practices, new products, use and safekeeping of customer funds and securities, extension of credit, money laundering, privacy, and record keeping. The Company also has established procedures that are designed to ensure that senior management's policies relating to conduct, ethics and business practices are followed.

### ***Credit Risk***

Credit risk is the risk of loss resulting from a client or counterparty failing to satisfy its contractual obligations with the Company or from the value of collateral held by the Company to secure obligations proving to be insufficient. The Company is primarily exposed to credit risk in its role as a lender to its customers and as a trading counterparty to dealers and customers.

The primary source of the Company's credit exposure is through customer margin loans, which are collateralized in accordance with internal and regulatory guidelines and monitored on a daily basis. Additional collateral is requested from customers when necessary to maintain compliance with internal and regulatory guidelines. Large customer margin loans and those margin loans related to concentrated or restricted positions are

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evaluated by the Company's Credit Committee, which is comprised of senior members of management from across the Company. The collateral requirements are increased, if necessary, to ensure the risk remains at an acceptable level.

The Company is also exposed to credit risk by providing clearing services for securities transactions in its client accounts and by participating in the securities lending business. The Company has an obligation to settle transactions with clearing organizations and other financial institutions and is exposed to loss if a client or counterparty fails to meet its obligations to the Company. The Company also executes securities lending activity in order to obtain financing and securities to support its business activities and its customers' trading activities. In most cases, the customer or counterparty has provided financial instruments as collateral for these transactions. The collateral value is monitored and additional collateral is obtained when appropriate.

See Note 11 (Financial Instruments - Off-Balance Sheet Risk and Concentration of Credit Risk) of the Notes to Consolidated Financial Statements for additional information related to credit risk.

### ***Market Risk***

Market risk is the potential change in value of financial instruments resulting from fluctuations in interest rates and/or equity prices. The Company's primary exposure to market risk comes from maintaining an inventory of fixed-income and equity security positions to provide investment products for its clients. The Company purchases only inventory that it believes it can readily sell to its clients, thus reducing the Company's exposure to liquidity risk but not market fluctuations. The Company does not act as a dealer, trader or end-user of complex derivative products such as swaps, collars and caps. The Company may provide advice and guidance on complex derivative products to selected clients; however, this activity does not involve the Company acquiring a position or commitment in these products.

*Interest Rate Risk.* Interest rate risk refers to the risk of changes in the level or volatility of interest rates, in the speed of payments on mortgage-backed securities, in the shape of the yield curve and in credit spreads. The Company is exposed to this risk as a result of maintaining inventories of interest-rate-sensitive financial instruments. This is the Company's primary market risk.

The Company manages its interest rate risk through the establishment and monitoring of trading policies and securities inventory guidelines and through the implementation of control and review procedures. The Company also manages this risk using hedging practices that involve U.S. Treasury obligations. On a daily basis, management monitors trading results, current inventory levels, concentrated inventory positions, and aged inventory positions. Real-time inventory data allows for intraday inventory management, and there is daily communication between trading department management and senior management regarding the Company's inventory positions and risk profile.

The Company elects to use a sensitivity analysis approach to express the potential decrease in the fair value of the Company's debt inventory consisting of interest-rate-sensitive financial instruments. The Company calculated the potential loss in fair value of its debt inventory by calculating the change in the valuation of its fixed-income security inventories resulting from an increase of 10 percent or 50 basis points, whichever is greater, in the Treasury yield curve. Using this method, if such an increase occurred the Company calculated a potential loss in fair value of its debt inventory of \$4 million at February 28, 2007, and 2006, respectively. The Company changed one assumption in its sensitivity analysis from the previous year. The Company no longer includes in its calculation those financial instruments with limited market risk exposure resulting from a short period of time until the interest rate resets. Including these financial instruments in the previous year's analysis, the resulting potential loss was calculated at \$10 million at February 28, 2006.

*Equity Price Risk.* Equity price risk refers to the risk of changes in the level or volatility of the price of equity securities. The Company is exposed to this risk as a result of its market making activities and other investment activities. The Company manages this risk by establishing guidelines for its equity inventories and managing position levels within those guidelines. At February 28, 2007, and 2006, the potential daily loss in the fair value of equity securities related to the Company's market-making activities was not material.

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Included in Investments are \$153 million in mutual funds that the Company uses to hedge its deferred compensation liability. The potential daily gain or loss in the fair value of these mutual funds is offset by a similar potential change in the value of the deferred compensation liability. Also included in Investments are \$175 million in private equity investments that are subject to a high degree of volatility and valuation estimates, and may be susceptible to significant fluctuations particularly in the near term.

### **Forward-Looking Statements**

The Management's Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Form 10-K may contain forward-looking statements within the meaning of federal securities laws. Actual results are subject to risks and uncertainties, including both those specific to the Company and those to the industry, which could cause results to differ materially from those contemplated. The risks and uncertainties include, but are not limited to, general economic conditions, government monetary and fiscal policy, the actions of competitors, changes in and effects of marketing strategies, client interest in specific products and services, the completion of all contractual, technological, legal and other requirements for the introduction of new products or services, regulatory changes and actions, changes in legislation, risk management, the impact of the AGE Bank Deposit Program and the expansion of powers of the Trust Company, legal claims, potential changes in compensation for or charges to financial consultants, technology changes, price adjustments, compensation

changes, the impact of outsourcing agreements, the impact of SFAS No. 123R, including the timing of the recognition of expenses and the treatment of expenses for retirement-eligible employees, the impact and value of the Company's investments including NYSE Euronext, the ability to achieve and the potential impact of acquisitions by the Company, implementation and effects of expense-reduction strategies, and efforts to make more of non-compensation expenses variable in nature. Undue reliance should not be placed on the forward-looking statements, which speak only as of the date of this Form 10-K. The Company does not undertake any obligation to publicly update any forward-looking statements.

**ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**

The information required by this item is contained in Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" under the caption "Risk Management" "Market Risk" of this Form 10-K.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.**

**Supplemental Data**

The quarterly financial data required by this item is included under Item 5 of Part II of this Form 10-K under the caption "Quarterly Information."

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
A.G. Edwards, Inc.  
St. Louis, Missouri

We have audited the accompanying consolidated balance sheets of A.G. Edwards, Inc. and subsidiaries (the "Company") as of February 28, 2007 and 2006, and the related consolidated statements of earnings, stockholders' equity, and cash flows for each of the three years in the period ended February 28, 2007. Our audits also included the financial statement schedule listed in the Index as Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of A.G. Edwards, Inc. and subsidiaries as of February 28, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended February 28, 2007, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 1 and Note 2 to the consolidated financial statements, in fiscal year 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment," and effective in fiscal year 2007, the Company changed its accounting policy for the recognition of equity awards granted to retirement-eligible employees, and retrospectively, adjusted the fiscal year 2006 financial statements for the change.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of February 28,

2007, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated April 27, 2007 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ Deloitte & Touche LLP

St. Louis, Missouri  
April 27, 2007

## Financial Statements

### A.G. Edwards, Inc. Consolidated Balance Sheets

|                                                                                                                        | February<br>28,<br>2007                             | February 28,<br>2006<br>(As<br>Adjusted,<br>See Note 2) |
|------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------|---------------------------------------------------------|
|                                                                                                                        | (Dollars in thousands,<br>except per share amounts) |                                                         |
| <b>Assets</b>                                                                                                          |                                                     |                                                         |
| Cash and cash equivalents                                                                                              | \$ 299,758                                          | \$ 178,173                                              |
| Cash and government securities deposited with clearing organizations or segregated under federal and other regulations | 406,852                                             | 272,881                                                 |
| Securities purchased under agreements to resell                                                                        | 815,044                                             | 195,000                                                 |
| Securities borrowed                                                                                                    | 306,310                                             | 205,774                                                 |
| Receivables:                                                                                                           |                                                     |                                                         |
| Customers, less allowance for doubtful accounts of \$2,700 and \$2,600                                                 | 1,710,857                                           | 2,084,278                                               |
| Brokers and dealers                                                                                                    | 130,989                                             | 187,092                                                 |
| Clearing organizations                                                                                                 | 2,015                                               | 809                                                     |
| Fees, dividends and interest                                                                                           | 160,375                                             | 118,465                                                 |
| Securities inventory, at fair value:                                                                                   |                                                     |                                                         |
| State and municipal                                                                                                    | 352,269                                             | 284,539                                                 |
| Government and agencies                                                                                                | 39,945                                              | 71,188                                                  |
| Corporate debt                                                                                                         | 55,194                                              | 35,638                                                  |
| Equities                                                                                                               | 7,634                                               | 22,788                                                  |
| Investments                                                                                                            | 406,021                                             | 367,822                                                 |
| Property and equipment, at cost, net of accumulated depreciation and amortization of \$728,485 and \$723,054           | 463,526                                             | 485,287                                                 |
| Deferred income taxes                                                                                                  | 106,947                                             | 107,114                                                 |
| Other assets                                                                                                           | 48,382                                              | 54,795                                                  |
|                                                                                                                        | \$ 5,312,118                                        | \$ 4,671,643                                            |
| <b>Liabilities and Stockholders' Equity</b>                                                                            |                                                     |                                                         |
| Checks payable                                                                                                         | \$ 287,962                                          | \$ 313,448                                              |
| Securities loaned                                                                                                      | 213,725                                             | 200,988                                                 |
| Payables:                                                                                                              |                                                     |                                                         |
| Customers                                                                                                              | 1,332,692                                           | 1,102,040                                               |
| Brokers and dealers                                                                                                    | 96,150                                              | 118,403                                                 |
| Clearing organizations                                                                                                 | 67,134                                              | 37,561                                                  |

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Securities sold but not yet purchased, at fair value:

|                                                                  |                  |                  |
|------------------------------------------------------------------|------------------|------------------|
| State and municipal                                              | 3,324            | 5,055            |
| Government and agencies                                          | 67,383           | 21,041           |
| Corporate debt                                                   | 8,523            | 18,174           |
| Equities                                                         | 492              | 1,372            |
| Employee compensation and related taxes                          | 577,918          | 495,828          |
| Deferred compensation                                            | 238,256          | 228,548          |
| Income taxes                                                     | 72,991           | 22,453           |
| Other liabilities                                                | 243,529          | 219,720          |
| <b>Total Liabilities</b>                                         | <b>3,210,079</b> | <b>2,784,631</b> |
| Stockholders' Equity:                                            |                  |                  |
| Preferred stock, \$25 par value:                                 |                  |                  |
| Authorized, 4,000,000 shares; none issued                        |                  |                  |
| Common stock, \$1 par value:                                     |                  |                  |
| Authorized, 550,000,000 shares; issued, 96,463,114 shares        | 96,463           | 96,463           |
| Additional paid-in capital                                       | 301,514          | 293,362          |
| Retained earnings                                                | 2,559,274        | 2,293,910        |
|                                                                  | 2,957,251        | 2,683,735        |
| Less: Treasury stock, at cost (21,146,664 and 20,872,779 shares) | 855,212          | 796,723          |
| <b>Total Stockholders' Equity</b>                                | <b>2,102,039</b> | <b>1,887,012</b> |
|                                                                  | \$ 5,312,118     | \$ 4,671,643     |

See Notes to Consolidated Financial Statements.

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**A.G. Edwards, Inc.**  
**Consolidated Statements of Earnings**

| Year Ended                        | February 28, 2007                                | February 28, 2006<br>(As Adjusted, See Note 2) | February 28, 2005 |
|-----------------------------------|--------------------------------------------------|------------------------------------------------|-------------------|
|                                   | (Dollars in thousands, except per share amounts) |                                                |                   |
| <b>Revenues</b>                   |                                                  |                                                |                   |
| Asset management and service fees | \$ 1,266,062                                     | \$ 1,062,872                                   | \$ 919,077        |
| Commissions                       | 1,031,957                                        | 1,017,716                                      | 1,034,166         |
| Principal transactions            | 215,130                                          | 210,110                                        | 253,899           |
| Investment banking                | 289,888                                          | 234,397                                        | 245,622           |
| Interest                          | 231,297                                          | 181,337                                        | 128,743           |
| Other                             | 91,743                                           | 44,334                                         | 30,288            |
| <b>Total Revenues</b>             | <b>3,126,077</b>                                 | <b>2,750,766</b>                               | <b>2,611,795</b>  |
| Interest expense                  | 15,617                                           | 10,653                                         | 4,114             |
| <b>Net Revenues</b>               | <b>3,110,460</b>                                 | <b>2,740,113</b>                               | <b>2,607,681</b>  |
| <b>Non-Interest Expenses</b>      |                                                  |                                                |                   |
| Compensation and benefits         | 1,931,870                                        | 1,761,199                                      | 1,699,156         |
| Communication and technology      | 257,838                                          | 236,379                                        | 241,830           |
| Occupancy and equipment           | 150,464                                          | 144,114                                        | 151,426           |



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|                                                                           |            |            |            |
|---------------------------------------------------------------------------|------------|------------|------------|
| Marketing and business development                                        | 76,950     | 71,635     | 65,682     |
| Floor brokerage and clearance                                             | 19,101     | 21,073     | 21,341     |
| Other                                                                     | 153,644    | 164,705    | 133,839    |
| Total Non-Interest Expenses                                               | 2,589,867  | 2,399,105  | 2,313,274  |
| Earnings Before Income Taxes                                              | 520,593    | 341,008    | 294,407    |
| Income Taxes                                                              | 189,240    | 117,684    | 107,933    |
| Earnings before cumulative effect of accounting change                    | 331,353    | 223,324    | 186,474    |
| Cumulative effect of accounting change, net of<br>\$1,655 of income taxes |            | 2,768      |            |
| Net Earnings                                                              | \$ 331,353 | \$ 226,092 | \$ 186,474 |
| <b>Earnings per diluted share:</b>                                        |            |            |            |
| Earnings before cumulative effect of accounting change                    | \$ 4.34    | \$ 2.89    | \$ 2.37    |
| Cumulative effect of accounting change, net of income taxes               |            | 0.04       |            |
| Earnings per diluted share                                                | \$ 4.34    | \$ 2.93    | \$ 2.37    |
| <b>Earnings per basic share:</b>                                          |            |            |            |
| Earnings before cumulative effect of accounting change                    | \$ 4.44    | \$ 2.91    | \$ 2.39    |
| Cumulative effect of accounting change, net of income taxes               |            | 0.04       |            |
| Earnings per basic share                                                  | \$ 4.44    | \$ 2.95    | \$ 2.39    |
| <b>Average common and common equivalent shares<br/>outstanding:</b>       |            |            |            |
| Diluted                                                                   | 76,431     | 77,204     | 78,766     |
| Basic                                                                     | 74,636     | 76,684     | 77,908     |

See Notes to Consolidated Financial Statements.

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**A.G. Edwards, Inc.**  
**Consolidated Statements of Stockholders' Equity**  
**Three Years Ended February 28, 2007**

|                                                  | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Treasury<br>Stock | Total<br>Stockholders'<br>Equity |
|--------------------------------------------------|-----------------|----------------------------------|----------------------|-------------------|----------------------------------|
| (Dollars in thousands, except per share amounts) |                 |                                  |                      |                   |                                  |
| <b>Balances, March 1, 2004</b>                   | \$ 96,463       | \$ 292,699                       | \$ 2,029,562         | \$ (640,405)      | \$ 1,778,319                     |
| Net Earnings                                     |                 |                                  | 186,474              |                   | 186,474                          |
| Dividends declared - \$0.64 per share            |                 |                                  | (49,392)             |                   | (49,392)                         |
| Treasury stock acquired                          |                 |                                  |                      | (250,123)         | (250,123)                        |
| Stock Issued:                                    |                 |                                  |                      |                   |                                  |
| Employee stock purchase/option<br>plans          |                 | 1,761                            | (25,436)             | 112,582           | 88,907                           |
| Restricted stock                                 |                 | 1,018                            | (4,094)              | 36,582            | 33,506                           |
| <b>Balances, February 28, 2005</b>               | 96,463          | 295,478                          | 2,137,114            | (741,364)         | 1,787,691                        |
| Net Earnings (As Adjusted, see Note<br>2)        |                 |                                  | 226,092              |                   | 226,092                          |
| Dividends declared - \$0.72 per share            |                 |                                  | (54,894)             |                   | (54,894)                         |
| Treasury stock acquired                          |                 |                                  |                      | (148,834)         | (148,834)                        |
| Stock Issued:                                    |                 |                                  |                      |                   |                                  |
|                                                  |                 | 557                              | (13,671)             | 90,104            | 76,990                           |

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|                                                 |           |            |              |              |              |
|-------------------------------------------------|-----------|------------|--------------|--------------|--------------|
| Employee stock purchase/option plans            |           |            |              |              |              |
| Restricted stock                                |           | (6,359)    | (731)        | 3,371        | (3,719)      |
| Tax benefits associated with stock-based awards |           | 3,686      |              |              | 3,686        |
| <b>Balances, February 28, 2006</b>              |           |            |              |              |              |
| (As Adjusted, See Note 2)                       | 96,463    | 293,362    | 2,293,910    | (796,723)    | 1,887,012    |
| Net Earnings                                    |           |            | 331,353      |              | 331,353      |
| Dividends declared - \$0.80 per share           |           |            | (60,664)     |              | (60,664)     |
| Treasury stock acquired                         |           |            |              | (199,679)    | (199,679)    |
| Stock Issued:                                   |           |            |              |              |              |
| Employee stock purchase/option plans            |           | 5,611      | (5,394)      | 98,357       | 98,574       |
| Restricted stock                                |           | (10,023)   | 69           | 42,833       | 32,879       |
| Tax benefits associated with stock-based awards |           | 12,564     |              |              | 12,564       |
| <b>Balances, February 28, 2007</b>              | \$ 96,463 | \$ 301,514 | \$ 2,559,274 | \$ (855,212) | \$ 2,102,039 |

See Notes to Consolidated Financial Statements.

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**A.G. Edwards, Inc.**  
**Consolidated Statements of Cash Flows**

| Year Ended                                                                                                             | February 28, 2007      | February 28, 2006 (As Adjusted, See Note 2) | February 28, 2005 |
|------------------------------------------------------------------------------------------------------------------------|------------------------|---------------------------------------------|-------------------|
|                                                                                                                        | (Dollars in thousands) |                                             |                   |
| <b>Cash Flows From Operating Activities:</b>                                                                           |                        |                                             |                   |
| Net earnings                                                                                                           | \$ 331,353             | \$ 226,092                                  | \$ 186,474        |
| Cumulative effect of accounting change, net of \$1,655 of income taxes                                                 |                        | (2,768)                                     |                   |
| Non-cash and nonoperating items included in earnings:                                                                  |                        |                                             |                   |
| Depreciation and amortization                                                                                          | 106,361                | 103,612                                     | 111,519           |
| Stock-based compensation                                                                                               | 40,269                 | 20,313                                      | 33,076            |
| Deferred income taxes                                                                                                  | 167                    | (48,580)                                    | 34,002            |
| (Gain) on investments, net                                                                                             | (78,591)               | (33,826)                                    | (21,798)          |
| Loss (Gain) on disposal of property and equipment                                                                      | 59                     | (2,169)                                     | 242               |
| Allowance for doubtful accounts                                                                                        | 403                    | 588                                         | (916)             |
| (Increase) decrease in operating assets:                                                                               |                        |                                             |                   |
| Cash and government securities deposited with clearing organizations or segregated under federal and other regulations | (133,971)              | 119,360                                     | (18,515)          |
| Securities purchased under agreements to resell                                                                        | (620,044)              | 40,540                                      | (213,185)         |
| Securities borrowed                                                                                                    | (100,536)              | (88,472)                                    | (11,268)          |
| Receivable from customers                                                                                              | 373,018                | 151,304                                     | 137,753           |
| Receivable from brokers and dealers                                                                                    | 56,103                 | (149,705)                                   | (23,499)          |
| Receivable from clearing organizations                                                                                 | (1,206)                | 705                                         | (709)             |
| Fees, dividends and interest receivable                                                                                | (41,910)               | (13,860)                                    | (14,552)          |
| Securities inventory                                                                                                   | (40,889)               | (13,950)                                    | 6,447             |
| Trading investments, net                                                                                               | (2,077)                | (5,748)                                     | (11,134)          |

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|                                                               |            |            |            |
|---------------------------------------------------------------|------------|------------|------------|
| Other assets                                                  | 6,413      | (2,558)    | (12,723)   |
| Increase (decrease) in operating liabilities:                 |            |            |            |
| Checks payable                                                | (25,486)   | 14,328     | 41,554     |
| Securities loaned                                             | 39,334     | (54,515)   | 68,224     |
| Payable to customers                                          | 230,652    | 352,139    | (375,113)  |
| Payable to brokers and dealers                                | (22,253)   | (537,083)  | 612,038    |
| Payable to clearing organizations                             | 29,573     | (42,691)   | (29,751)   |
| Securities sold but not yet purchased                         | 34,080     | 9,203      | (8,469)    |
| Employee compensation and related taxes                       | 74,701     | 35,384     | 69         |
| Deferred compensation                                         | 9,708      | 4,727      | 17,087     |
| Income taxes                                                  | 50,538     | 15,075     | (1,521)    |
| Other liabilities                                             | 27,146     | 33,350     | 21,711     |
| Net cash from operating activities                            | 342,915    | 130,795    | 527,043    |
| <b>Cash Flows From Investing Activities:</b>                  |            |            |            |
| Purchase of property and equipment                            | (90,243)   | (85,837)   | (117,031)  |
| Purchase of other investments                                 | (18,150)   | (23,158)   | (22,008)   |
| Proceeds from sale of a subsidiary                            | □          | □          | 10,830     |
| Proceeds from disposal of property and equipment              | 2,298      | 3,083      | □          |
| Proceeds from sale or maturity of other investments           | 60,619     | 32,304     | 22,620     |
| Net cash from investing activities                            | (45,476)   | (73,608)   | (105,589)  |
| <b>Cash Flows From Financing Activities:</b>                  |            |            |            |
| Short-term bank loans, net                                    | □          | (16,400)   | (11,900)   |
| Securities loaned                                             | (26,597)   | 48,491     | (92,650)   |
| Employee stock transactions                                   | 98,574     | 76,991     | 84,648     |
| Tax benefit associated with stock-based awards                | 12,564     | 3,686      | □          |
| Cash dividends paid                                           | (60,716)   | (51,987)   | (49,955)   |
| Purchase of treasury stock                                    | (199,679)  | (148,834)  | (250,123)  |
| Net cash from financing activities                            | (175,854)  | (88,053)   | (319,980)  |
| Net Increase (Decrease) in Cash and Cash Equivalents          | 121,585    | (30,866)   | 101,474    |
| Cash and Cash Equivalents, at Beginning of Year               | 178,173    | 209,039    | 107,565    |
| Cash and Cash Equivalents, at End of Year                     | \$ 299,758 | \$ 178,173 | \$ 209,039 |
| <b>Supplemental Disclosure of Cash Flow Information:</b>      |            |            |            |
| Cash paid for:                                                |            |            |            |
| Income taxes                                                  | \$ 126,320 | \$ 147,777 | \$ 75,006  |
| Interest, net of amounts capitalized of \$25, \$431 and \$612 | \$ 16,078  | \$ 10,768  | \$ 3,954   |
| <b>Non-Cash Investing Activity:</b>                           |            |            |            |
| Property purchased included in other liabilities              | \$ 5,257   | \$ □       | \$ □       |
| <b>Non-Cash Financing Activity:</b>                           |            |            |            |
| Restricted stock awards granted                               | \$ 52,656  | \$ □       | \$ 35,062  |

See Notes to Consolidated Financial Statements.

A.G. Edwards, Inc.

**Notes to Consolidated Financial Statements**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**1. Summary of Significant Accounting Policies**

## **Business Description**

A.G. Edwards, Inc. and its wholly-owned subsidiaries (collectively referred to as the "Company") operate and are managed as a single business segment providing investment services to its clients. The Company's principal operating subsidiary is A.G. Edwards & Sons, Inc., ("Edwards"). The Company offers a wide range of services designed to meet clients' individual investment needs, including securities and commodities brokerage, investment banking, trust, asset management, retirement and financial planning, insurance products, and other related financial services to individual, corporate, governmental, municipal and institutional clients through one of the industry's largest retail branch distribution systems. These services are provided by the Company's 6,618 financial consultants in 744 locations. Because these services are provided using the same sales and distribution personnel, support services and facilities, and all are provided to meet the needs of its clients, the Company does not identify or manage assets, revenues or expenses resulting from any service, or class of services, as a separate business segment. With headquarters in St. Louis, the Company has offices in 50 states, the District of Columbia, London, England and Geneva, Switzerland.

## **Basis of Financial Information**

The consolidated financial statements of the Company are prepared in conformity with accounting principles generally accepted in the United States of America. All material intercompany balances and transactions have been eliminated in consolidation.

## **Use of Estimates**

In preparing these consolidated financial statements, management makes use of estimates concerning certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and certain revenues and expenses during the reporting period. Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ from those estimates and could have a material impact on the consolidated financial statements, and it is possible that such changes could occur in the near term. Certain areas in which estimates are significant to the amounts reported in the consolidated financial statements include: valuation of investments, the outcome of certain litigation and regulatory matters, allowance for doubtful accounts from customers, accrual for income taxes and the valuation of stock options.

## **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 acquisition.

## **Securities Transactions**

Securities purchased under agreements to resell ("Resale Agreements") and securities sold under agreements to repurchase are recorded at the contractual amounts that the securities will be resold/repurchased, including accrued interest. The Company's policy is to obtain possession or control of securities purchased under Resale Agreements and to obtain additional collateral when necessary to minimize the risk associated with this activity. The Company nets Resale Agreements and securities sold under agreements to repurchase, where applicable. Substantially all of these transactions are executed under master repurchase agreements, which give the Company right of offset in the event of counterparty default.

Securities borrowed and securities loaned are recorded at the amount of the cash collateral provided for securities borrowed transactions and received for securities loaned transactions, respectively. The adequacy of the collateral is continuously monitored and adjusted when considered necessary to minimize the risk associated with this activity. Substantially all of these transactions are executed under master securities lending agreements, which gives the Company right of offset in the event of counterparty default. Such receivables and payables from the same counterparty are not offset in the consolidated balance sheets.

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**1. Summary of Significant Accounting Policies (Continued)**

Customer securities transactions are recorded on settlement date. Revenues and related expenses for transactions executed but unsettled are accrued on a trade-date basis. Receivables from and payables to customers include amounts due on cash and margin transactions. Securities owned by customers, including those that collateralize margin or other similar transactions, are not reflected on the consolidated balance sheets.

**Asset Management and Service Fees**

Asset management and service fee revenues consist of fees based on the value of client assets under professional management by third parties as well as the Company's asset management services, transaction-related service fees and fees related to the administration of custodial and other specialty accounts. These revenues are recognized over the periods for which services are rendered.

**Investment Banking**

Investment banking revenue includes management fees, selling concessions, and underwriting fees arising from securities offerings in which the Company acts as an underwriter or agent for consulting, private placement, or merger and acquisition transactions. Investment banking management fees are recorded on the offering date, selling concessions on trade date, and underwriting fees are accrued at settlement date and adjusted to actual net of expenses at the time the final underwriting settlement is completed. Transaction-related expenses are deferred and either reimbursed or later expensed to match revenue recognition.

**Allowance for Doubtful Accounts**

Receivables from customers, primarily consisting of floating rate loans collateralized by margin securities, are charged interest at rates similar to other such loans made throughout the industry. Management estimates an allowance for doubtful accounts to reserve for potential losses from unsecured and partially secured customer accounts deemed uncollectible. The facts and circumstances surrounding each receivable from customers and the number of shares, price and volatility of the underlying collateral are considered by management in determining the allowance. Management continually evaluates its receivables from customers for collectibility and possible write-off. The Company manages the credit risk associated with its receivables from customers through credit limits and continuous monitoring of collateral.

**Securities Inventory**

Securities inventory, securities sold but not yet purchased, and securities segregated under federal and other regulations are recorded on a trade-date basis and are carried at fair value. Fair value is based on quoted market or dealer prices, pricing models, or management's estimates. Realized and unrealized gains are reflected in principal transactions on a trade-date basis.

**Investments**

Investments consist of private equity investments, mutual funds, U.S. government securities and other investments. Private equity investments are held by investment company subsidiaries and are carried at fair value. The Company's mutual fund investments are trading securities and are recorded at fair value. U.S. government securities are classified as held-to-maturity and are held at amortized cost as the Company has the intent and ability to hold the securities to maturity. The majority of other investments include securities held by the Company's broker-dealer subsidiary and are recorded at fair value. The unrealized gains and losses of investment securities are reflected in other revenue.

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**1. Summary of Significant Accounting Policies (Continued)**

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

**Property and Equipment**

Property and equipment are carried at cost less accumulated depreciation and amortization; land is recorded at cost. Depreciation of buildings is provided using the straight-line method over estimated useful lives of 20 to 40 years. Leasehold improvements are amortized over the lesser of the life of the lease or estimated useful life of the improvement, generally five to 10 years. Equipment, primarily consisting of office equipment and building components, is depreciated over estimated useful lives of three to 15 years using the straight-line method as well as accelerated methods of depreciation. Computer hardware, including servers and mainframes, and satellite equipment are depreciated over estimated useful lives of three to five years using the straight-line method. Internally developed applications and purchased software meeting the criteria for capitalization are amortized over their estimated useful lives, generally not exceeding three years, using the straight-line method. The Company periodically evaluates and adjusts the carrying value of its property and equipment when impairment exists.

**Stock-Based Compensation**

The Company applies the provisions of Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS No. 123R), and related interpretations to account for its 1988 Incentive Stock Plan, as amended, which consists of stock options and restricted stock. The Company early adopted SFAS No. 123R on March 1, 2005. Based on the provisions of the 1988 Incentive Stock Plan, the Company uses the grant date fair value for stock options and restricted stock to determine its cost and recognizes the related expense over the service period of the award, generally three years following the award to non retirement-eligible employees. Based on interpretive guidance related to SFAS 123R, on March 1, 2006, the Company changed its accounting method for recognizing the cost of Stock Awards that are granted to retirement-eligible employees. For retirement-eligible employees, the Company accrues an expense prior to the date of grant rather than recognizing the expense on grant date, which typically occurs in the first quarter of the subsequent fiscal year. Prior to the adoption of SFAS No. 123R, the Company applied Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees (APB No. 25) to account for its stock based awards. See Note 2 (Employee Stock Plans) for additional information related to stock-based compensation.

**Income Taxes**

Income tax expense is provided for using the asset and liability method, under which deferred tax assets and liabilities are determined based upon the temporary differences between the financial statement and income tax bases of assets and liabilities, using current tax rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

**Comprehensive Earnings**

Comprehensive earnings for each of the three years in the period ended February 28, 2007, was equal to the Company's net earnings.

**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**1. Summary of Significant Accounting Policies (Continued)**

**Recent Accounting Pronouncements**

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, "The Fair Value Option for Financial Assets and Liabilities, including an amendment of FASB Statement No. 115" (SFAS No. 159). SFAS No. 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses shall be reported on items for which the fair value option has been elected in earnings at each subsequent reporting date. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of SFAS No. 157 "Fair Value Measurements" (SFAS No. 157). The Company is currently assessing the impact that SFAS No. 159 will have on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB Statements No. 87, 88, 106, and 132(R)," (SFAS No. 158). SFAS No. 158 requires employers to recognize the overfunded or underfunded status of a defined benefit post-retirement plan as an asset or liability in its statement of financial position. Further, this statement requires employers to recognize changes in the funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 is effective for fiscal years ending after December 15, 2006. The Company's adoption of SFAS No. 158 did not have a material impact on the consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurement. This statement applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact that SFAS No. 157 will have on the consolidated financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in the Current Year Financial Statements" (SAB 108). SAB 108 addresses how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements. SAB 108 requires an entity to quantify misstatements using a balance sheet and income statement approach and to evaluate whether either approach results in quantifying an error that is material in light of relevant quantitative and qualitative factors. SAB No. 108 is effective for fiscal years ending after November 15, 2006. The Company's adoption of SAB No. 108 did not have a material impact on the consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements and prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt the provisions of FIN 48 beginning in the first quarter of 2008. The Company is currently assessing the impact that FIN 48 will have on the consolidated financial statements.

In June 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections" a replacement of APB Opinion No. 20 and FASB Statement No. 3, (SFAS No. 154). SFAS No. 154 changes the requirements for the accounting for and reporting of a change in accounting method. SFAS No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. The Company adopted SFAS No. 154 on March 1, 2006,

and applied the pronouncement to its change in accounting method for restricted stock and stock options (collectively referred to as "Stock Awards") granted to retirement-eligible employees.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**2. Employee Stock Plans**

The Company grants options and restricted stock to employees utilizing two shareholder-approved plans. The 2002 Employee Stock Purchase Plan, as amended, (the "ESPP") is a qualified plan, as defined under section 423 of the Internal Revenue Code, used to grant options to purchase the Company's stock at a discount from market value to a broad base of employees. The 1988 Incentive Stock Plan, as amended, is a non-qualified plan used to grant Stock Awards at market value to certain officers and key employees. The Company expensed \$39,938, \$19,611 and \$34,700 associated with its employee stock plans for the fiscal years ended February 28, 2007, 2006 and 2005, respectively. As of February 28, 2007, there was \$22,348 of unrecognized compensation cost related to nonvested Stock Awards, which is expected to be recognized over a remaining weighted-average period of two years. The excess tax benefit recognized for Stock Awards was \$12,564, \$3,686 and \$4,689 for the 2007, 2006 and 2005 fiscal years, respectively.

SFAS No. 123R and its related interpretations were early adopted on March 1, 2005, and require the recognition of the cost of employee services received in exchange for Stock Awards in the financial statements over the period the employee is required to perform the services in exchange for the award (presumptively the service period). SFAS No. 123R also requires measurement of the cost of employee services received in exchange for an award based on the grant-date fair value of the award.

Upon adoption of SFAS No. 123R using the modified prospective approach, the Company recognized a \$4,423 benefit (\$2,768 after-tax) during the first fiscal quarter of 2006, as the cumulative effect of a change in accounting method resulting from the requirement to estimate forfeitures of restricted stock awards at the date of grant instead of recognizing them as incurred. The cumulative benefit, net of tax, increased earnings per diluted and basic share by \$0.04.

In addition, as a result of adopting SFAS No. 123R and the change in accounting method discussed in the next paragraph, the Company's retrospective application resulted in the recording of compensation expense only for Stock Awards to retirement-eligible employees in 2006, as all compensation expense related to outstanding awards had already been recognized or disclosed in the consolidated financial statements of previous periods. Prior to March 1, 2005, under APB No. 25, the Company recognized compensation expense related to restricted stock in net earnings in the year of grant, but did not recognize any associated compensation expense related to stock options.

Upon the adoption of SFAS No. 123R on March 1, 2005, the Company recognized the compensation expense related to Stock Awards to retirement-eligible employees on the date of grant. Based on interpretive guidance related to SFAS No. 123R, on March 1, 2006, the Company changed its accounting method for recognizing the cost of Stock Awards that are granted to retirement-eligible employees. The Company is accruing an expense throughout the fiscal year preceding the date of grant representing an estimate of Stock Awards to be granted to retirement-eligible employees as a result of such fiscal year's service rather than recognize the expense on grant date, which occurs in the first quarter of the subsequent fiscal year. The accounting for Stock Awards to non-retirement eligible employees will not change and will be recognized over the service period, generally three years from grant date. The Company determined that the changed accounting method is preferable because it better reflects the compensation expense for Stock Awards to retirement-eligible employees over the period in which Stock Awards are earned.



## A.G. Edwards, Inc.

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
(Dollars in thousands, except share and per share amounts)

**2. Employee Stock Plans (Continued)**

As a result of this change, under SFAS No. 154, the comparative periods' consolidated financial statements include the retrospective application of this change in accounting method. See below for the impact of the change on the current and prior periods reported consolidated financial statements. The column labeled "As Computed" shows the consolidated financial statements as if the Company had continued to expense Stock Awards to retirement-eligible employees on the date of grant.

**Consolidated Balance Sheet**  
**February 28, 2007**

|                                            | <b>Expense Retirement-Eligible Stock Awards over Service Period</b> | <b>Expense Retirement-Eligible Stock Awards on Grant Date</b> | <b>Effect of</b> |
|--------------------------------------------|---------------------------------------------------------------------|---------------------------------------------------------------|------------------|
|                                            | <i>As Reported</i>                                                  | <i>As Computed</i>                                            | <b>Change</b>    |
| Deferred income taxes                      | \$ 106,947                                                          | \$ 104,906                                                    | \$ 2,041         |
| Total Assets                               | \$ 5,312,118                                                        | \$ 5,310,077                                                  | \$ 2,041         |
| Employee compensation and related taxes    | \$ 577,918                                                          | \$ 552,849                                                    | \$ 25,069        |
| Total Liabilities                          | \$ 3,210,079                                                        | \$ 3,185,010                                                  | \$ 25,069        |
| Additional paid-in capital                 | \$ 301,514                                                          | \$ 321,125                                                    | \$ (19,611)      |
| Retained earnings                          | \$ 2,559,274                                                        | \$ 2,562,691                                                  | \$ (3,417)       |
| Total Stockholders' Equity                 | \$ 2,102,039                                                        | \$ 2,125,067                                                  | \$ (23,028)      |
| Total Liabilities and Stockholders' Equity | \$ 5,312,118                                                        | \$ 5,310,077                                                  | \$ 2,041         |

**Consolidated Balance Sheet**  
**February 28, 2006**

|                                            | <b>Expense Retirement-Eligible Stock Awards over Service Period</b> | <b>Expense Retirement-Eligible Stock Awards on Grant Date</b> | <b>Effect of</b> |
|--------------------------------------------|---------------------------------------------------------------------|---------------------------------------------------------------|------------------|
|                                            | <i>As Adjusted</i>                                                  | <i>As Originally Reported</i>                                 | <b>Change</b>    |
| Deferred income taxes                      | \$ 107,114                                                          | \$ 99,740                                                     | \$ 7,374         |
| Total Assets                               | \$ 4,671,643                                                        | \$ 4,664,269                                                  | \$ 7,374         |
| Employee compensation and related taxes    | \$ 495,828                                                          | \$ 476,217                                                    | \$ 19,611        |
| Total Liabilities                          | \$ 2,784,631                                                        | \$ 2,765,020                                                  | \$ 19,611        |
| Retained earnings                          | \$ 2,293,910                                                        | \$ 2,306,147                                                  | \$ (12,237)      |
| Total Stockholders' Equity                 | \$ 1,887,012                                                        | \$ 1,899,249                                                  | \$ (12,237)      |
| Total Liabilities and Stockholders' Equity | \$ 4,671,643                                                        | \$ 4,664,269                                                  | \$ 7,374         |

## A.G. Edwards, Inc.

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**

(Dollars in thousands, except share and per share amounts)

## 2. Employee Stock Plans (Continued)

**Consolidated Statement of Earnings**  
**Fiscal Year Ended**  
**February 28, 2007**

|                                                                             | Expense<br>Retirement-<br>Eligible Stock<br>Awards<br>over Service<br>Period<br><i>As Reported</i> | Expense<br>Retirement-<br>Eligible Stock<br>Awards<br>on Grant Date<br><i>As Computed</i> | Effect of<br>Change |
|-----------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------|---------------------|
| Compensation and benefits expense                                           | \$ 1,931,870                                                                                       | \$ 1,926,412                                                                              | \$ 5,458            |
| Earnings before income taxes                                                | \$ 520,593                                                                                         | \$ 526,051                                                                                | \$ (5,458)          |
| Income Taxes                                                                | \$ 189,240                                                                                         | \$ 191,281                                                                                | \$ (2,041)          |
| Earnings before cumulative effect of<br>accounting change                   | \$ 331,353                                                                                         | \$ 334,770                                                                                | \$ (3,417)          |
| Net Earnings                                                                | \$ 331,353                                                                                         | \$ 334,770                                                                                | \$ (3,417)          |
| Earnings per diluted share before cumulative effect<br>of accounting change | \$ 4.34                                                                                            | \$ 4.39                                                                                   | \$ (0.05)           |
| Earnings per diluted share                                                  | \$ 4.34                                                                                            | \$ 4.39                                                                                   | \$ (0.05)           |
| Earnings per basic share before cumulative effect of<br>accounting change   | \$ 4.44                                                                                            | \$ 4.49                                                                                   | \$ (0.05)           |
| Earnings per basic share                                                    | \$ 4.44                                                                                            | \$ 4.49                                                                                   | \$ (0.05)           |

**Consolidated Statement of Earnings**  
**Fiscal Year Ended**  
**February 28, 2006**

|                                                                             | Expense<br>Retirement-<br>Eligible Stock<br>Awards<br>over Service Period<br><i>As Adjusted</i> | Expense<br>Retirement-<br>Eligible Stock<br>Awards<br>on Grant Date<br><i>As Originally<br/>Reported</i> | Effect of<br>Change |
|-----------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------|---------------------|
| Compensation and benefits expense                                           | \$ 1,761,199                                                                                    | \$ 1,741,588                                                                                             | \$ 19,611           |
| Earnings before income taxes                                                | \$ 341,008                                                                                      | \$ 360,619                                                                                               | \$ (19,611)         |
| Income Taxes                                                                | \$ 117,684                                                                                      | \$ 125,058                                                                                               | \$ (7,374)          |
| Earnings before cumulative effect of<br>accounting change                   | \$ 223,324                                                                                      | \$ 235,561                                                                                               | \$ (12,237)         |
| Net Earnings                                                                | \$ 226,092                                                                                      | \$ 238,329                                                                                               | \$ (12,237)         |
| Earnings per diluted share before cumulative effect<br>of accounting change | \$ 2.89                                                                                         | \$ 3.06                                                                                                  | \$ (0.17)           |
| Earnings per diluted share                                                  | \$ 2.93                                                                                         | \$ 3.10                                                                                                  | \$ (0.17)           |
| Earnings per basic share before cumulative effect of<br>accounting change   | \$ 2.91                                                                                         | \$ 3.07                                                                                                  | \$ (0.16)           |
| Earnings per basic share                                                    | \$ 2.95                                                                                         | \$ 3.11                                                                                                  | \$ (0.16)           |

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
(Dollars in thousands, except share and per share amounts)

**2. Employee Stock Plans (Continued)**

**Consolidated Statement of Stockholders' Equity**  
**Fiscal Year Ended**  
**February 28, 2007**

|                            | Expense<br>Retirement-<br>Eligible Stock<br>Awards | Expense<br>Retirement-<br>Eligible Stock<br>Awards | Effect of<br>Change |
|----------------------------|----------------------------------------------------|----------------------------------------------------|---------------------|
|                            | over Service Period<br><i>As Reported</i>          | on Grant Date<br><i>As Computed</i>                |                     |
| Net earnings               | \$ 331,353                                         | \$ 334,770                                         | \$ (3,417)          |
| Retained earnings          | \$ 2,559,274                                       | \$ 2,562,691                                       | \$ (3,417)          |
| Additional paid-in capital | \$ 301,514                                         | \$ 321,125                                         | \$ (19,611)         |
| Total Stockholders' Equity | \$ 2,102,039                                       | \$ 2,125,067                                       | \$ (23,028)         |

**Consolidated Statement of Stockholders' Equity**  
**Fiscal Year Ended**  
**February 28, 2006**

|                            | Expense<br>Retirement-<br>Eligible Stock<br>Awards | Expense<br>Retirement-<br>Eligible Stock<br>Awards | Effect of<br>Change |
|----------------------------|----------------------------------------------------|----------------------------------------------------|---------------------|
|                            | over Service Period<br><i>As Adjusted</i>          | on Grant Date<br><i>As Originally<br/>Reported</i> |                     |
| Net earnings               | \$ 226,092                                         | \$ 238,329                                         | \$ (12,237)         |
| Retained earnings          | \$ 2,293,910                                       | \$ 2,306,147                                       | \$ (12,237)         |
| Additional paid-in capital | \$ 293,362                                         | \$ 293,362                                         | \$ —                |
| Total Stockholders' Equity | \$ 1,887,012                                       | \$ 1,899,249                                       | \$ (12,237)         |

**Consolidated Statement of Cash Flows**  
**Fiscal Year Ended**  
**February 28, 2007**

|                                                                              | Expense<br>Retirement-<br>Eligible Stock<br>Awards | Expense<br>Retirement-<br>Eligible Stock<br>Awards | Effect of<br>Change |
|------------------------------------------------------------------------------|----------------------------------------------------|----------------------------------------------------|---------------------|
|                                                                              | over Service Period<br><i>As Reported</i>          | on Grant Date<br><i>As Computed</i>                |                     |
| Net earnings                                                                 | \$ 331,353                                         | \$ 334,770                                         | \$ (3,417)          |
| Other non-cash items included in net earnings:                               |                                                    |                                                    |                     |
| Stock-based compensation                                                     | \$ 40,269                                          | \$ 32,880                                          | \$ 7,389            |
| Deferred income taxes                                                        | \$ 167                                             | \$ 2,208                                           | \$ (2,041)          |
| Change in operating liabilities — employee<br>compensation and related taxes | \$ 74,701                                          | \$ 76,632                                          | \$ (1,931)          |
| Net cash from operating activities                                           | \$ 342,915                                         | \$ 342,915                                         | \$ —                |
| Net increase in cash and cash equivalents                                    | \$ 121,585                                         | \$ 121,585                                         | \$ —                |
| Cash and cash equivalents, at beginning of year                              | \$ 178,173                                         | \$ 178,173                                         | \$ —                |
| Cash and cash equivalents, at end of year                                    | \$ 299,758                                         | \$ 299,758                                         | \$ —                |

## A.G. Edwards, Inc.

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
(Dollars in thousands, except share and per share amounts)

**2. Employee Stock Plans (Continued)**

**Consolidated Statement of Cash Flows**  
**Fiscal Year Ended**  
**February 28, 2006**

|                                                                           | <b>Expense<br/>Retirement-<br/>Eligible Stock<br/>Awards<br/>over Service<br/>Period</b> | <b>Expense<br/>Retirement-<br/>Eligible Stock<br/>Awards<br/>on Grant Date<br/>As Originally<br/>Reported</b> | <b>Effect of<br/>Change</b> |
|---------------------------------------------------------------------------|------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------|-----------------------------|
|                                                                           | <i>As Adjusted</i>                                                                       |                                                                                                               |                             |
| Net earnings                                                              | \$ 226,092                                                                               | \$ 238,329                                                                                                    | \$ (12,237)                 |
| Other non-cash items included in net earnings:                            |                                                                                          |                                                                                                               |                             |
| Stock-based compensation                                                  | \$ 20,313                                                                                | \$ 702                                                                                                        | \$ 19,611                   |
| Deferred income taxes                                                     | \$ (48,580)                                                                              | \$ (41,206)                                                                                                   | \$ (7,374)                  |
| Change in operating liabilities □ employee compensation and related taxes | \$ 35,384                                                                                | \$ 35,384                                                                                                     | \$ □                        |
| Net cash from operating activities                                        | \$ 130,795                                                                               | \$ 130,795                                                                                                    | \$ □                        |
| Net decrease in cash and cash equivalents                                 | \$ (30,866)                                                                              | \$ (30,866)                                                                                                   | \$ □                        |
| Cash and cash equivalents, at beginning of year                           | \$ 209,039                                                                               | \$ 209,039                                                                                                    | \$ □                        |
| Cash and cash equivalents, at end of year                                 | \$ 178,173                                                                               | \$ 178,173                                                                                                    | \$ □                        |

As previously discussed, prior to March 1, 2005, under APB No. 25, the Company recognized compensation expense related to restricted stock in net earnings in the year of grant, but did not recognize any associated compensation expense related to stock options. Had compensation expense associated with these plans been determined in accordance with Statement of Financial Accounting Standards No. 123, □Accounting for Stock-Based Compensation,□ the Company□s net earnings and earnings per share would have been as follows for 2005:

|                                                                                 | <b>2005</b> |
|---------------------------------------------------------------------------------|-------------|
| Net earnings, as reported                                                       | \$ 186,474  |
| Add back compensation related to Incentive Stock Plans included in net earnings | 21,720      |
| Deduct effect of stock option based employee compensation:                      |             |
| Employee Stock Purchase Plan                                                    | (8,776)     |
| Incentive Stock Plan                                                            | (25,125)    |
| Pro forma net earnings                                                          | \$ 174,293  |
| Earnings per share, as reported:                                                |             |
| Diluted                                                                         | \$ 2.37     |
| Basic                                                                           | \$ 2.39     |
| Pro forma earnings per share:                                                   |             |
| Diluted                                                                         | \$ 2.20     |
| Basic                                                                           | \$ 2.24     |

|                                                                         |            |
|-------------------------------------------------------------------------|------------|
| Pro forma net earnings                                                  | \$ 174,293 |
| Add back reduction in incentive compensation funding formulas           | 3,349      |
| Pro forma net earnings after reduction for incentive compensation plans | \$ 177,642 |
| Pro forma earnings per share:                                           |            |
| Diluted                                                                 | \$ 2.24    |
| Basic                                                                   | \$ 2.28    |

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

The Black-Scholes option pricing model was used to calculate the estimated fair value of the options for the Employee Stock Purchase Plan using the following assumptions: dividend yield of 1.83 percent; an expected life of one year; expected volatility of 29 percent and risk-free interest rate of 0.95 percent. The assumptions related to the Incentive Stock Plan are presented on page 51.

## **2. Employee Stock Plans (Continued)**

### **Employee Stock Purchase Plan**

The Company amended the terms of its 2002 ESPP effective October 1, 2004. The discount from the market under the plan was reduced to 5 percent from 15 percent and the one year look-back period for the options issued under the plan was eliminated. As a result of these changes, the options granted under this plan are no longer considered compensatory for purposes of the pro forma earnings disclosed above or under SFAS No. 123R.

The Company's Board of Directors authorized for the plan year ended September 30, 2006, up to 1,875,000 shares of common stock to be purchased by employees under the ESPP. The Company's Board of Directors authorized for the plan year beginning October 1, 2006 and ending September 30, 2007, up to 1,200,000 shares of common stock to be purchased by employees under the ESPP. These shares are purchased in monthly installments at 95 percent of the market price on the last business day of each month. Employees purchased an aggregate of 703,396 shares at an average price of \$53.11 per share of common stock during 2007; 875,828 shares at an average price of \$41.56 per share of common stock during 2006; and an aggregate of 359,555 shares at an average price of \$38.78 per share of common stock on the last business day of October 2004 through February 2005. Treasury shares were utilized for all of the shares purchased.

Under the 2002 ESPP, prior to its most recent amendment, employees purchased 1,843,334 shares at \$29.54 per share in 2005. Treasury shares were utilized for all of the shares issued. The pro forma disclosure in the preceding table reflects the fair values of the options over the period when the options from each grant date were outstanding.

### **Restricted Stock and Stock Options**

Under the Company's 1988 Incentive Stock Plan, three types of benefits may be awarded to officers and key employees: restricted stock, stock options and stock appreciation rights. Such grants are subject to forfeiture upon termination of employment during a restricted period, generally three years from the award date. Through February 28, 2007, no stock appreciation rights had been granted.

Restricted stock grants are made, and shares issued, without cash payment by the employee. In fiscal year 2008, the Company granted 339,479 shares of restricted stock to retirement-eligible employees and granted 622,105 shares of restricted stock to non-retirement eligible employees, with a fair value of \$68,744. The awards to non-retirement eligible employees were for service performed in fiscal year 2007 and will be expensed, as

appropriate, over the service period, generally three years. The awards to retirement-eligible employees were expensed during the fiscal year 2007. The Company granted employees 1,030,024 restricted shares with a fair value of \$52,851, in fiscal year 2007 for service performed in fiscal year 2006. For service performed in fiscal year 2005, eligible employees were granted 792,544 shares with a fair value of \$35,062. In accordance with APB No. 25, compensation expense associated with this grant was recorded in fiscal year 2005. Treasury shares were utilized for these grants.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**2. Employee Stock Plans (Continued)**

The following table sets forth activity relating to the Company's unvested restricted stock:

|                                                | Shares | 2007<br>Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value | Shares | 2006<br>Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value | Shares | 2005<br>Weighted<br>Average<br>Grant<br>Date<br>Fair<br>Value |
|------------------------------------------------|--------|---------------------------------------------------------------|--------|---------------------------------------------------------------|--------|---------------------------------------------------------------|
|                                                | (000)  |                                                               | (000)  |                                                               | (000)  |                                                               |
| Unvested restricted stock at beginning of year | 2,182  | \$ 36.95                                                      | 2,794  | \$ 37.52                                                      | 2,910  | \$ 35.44                                                      |
| Granted                                        | 1,031  | \$ 51.32                                                      | 4      | \$ 42.68                                                      | 792    | \$ 44.23                                                      |
| Issued (vested)                                | (778)  | \$ 27.77                                                      | (556)  | \$ 40.01                                                      | (840)  | \$ 36.87                                                      |
| Forfeited                                      | (53)   | \$ 44.66                                                      | (60)   | \$ 35.65                                                      | (68)   | \$ 34.72                                                      |
| Unvested restricted stock at end of year       | 2,382  | \$ 45.99                                                      | 2,182  | \$ 36.95                                                      | 2,794  | \$ 37.52                                                      |
| Treasury shares utilized for grants            | 1,031  |                                                               | 4      |                                                               | 792    |                                                               |

Nonqualified stock options are granted to purchase common stock at 100 percent of market value at the date of grant. Such options are exercisable beginning three years from date of grant and expire eight years from date of grant for options granted prior to fiscal year 2003 and 10 years for awards granted in fiscal year 2003 and after or earlier upon termination of employment. No options were granted during fiscal year 2006. The weighted average fair value of options granted under this plan in fiscal years 2007 and 2005 were \$18.59 and \$17.08, respectively, utilizing the following weighted average assumptions:

|                                 | 2007   | 2006 | 2005   | 2004   |
|---------------------------------|--------|------|--------|--------|
| Risk-free interest rate         | 5.05%  | □    | 4.27%  | 3.67%  |
| Expected option life in years   | 7      | □    | 7      | 7      |
| Expected stock price volatility | 34.29% | □    | 37.15% | 43.01% |
| Expected dividend yield         | 1.80%  | □    | 1.72%  | 1.83%  |

The fair value of each option award is estimated on the date of grant based on a Black-Scholes option pricing model. Expected option life for options granted reflects the application of the simplified method set out in SEC Staff Accounting Bulletin No. 107 (□SAB 107□). The simplified method defines the expected option life as the average of the contractual term of the options and the weighted average vesting period for all option transactions. The risk-free interest rate represents the U.S. Treasury yield in effect at the time of the stock option grant, expected stock price volatility is based on historical volatility of the Company's common stock and the expected dividend yield is based on the current dividend rate at the time of grant.

In fiscal year 2008, the Company granted 114,723 options to retirement-eligible employees and granted 152,372 options to non-retirement eligible employees, with a fair value of \$6,667. The awards to non-retirement eligible employees were for service performed in fiscal year 2007 and will be expensed, as appropriate, over the service period, generally three years. The awards to retirement-eligible employees were expensed during the fiscal year 2007. The Company granted 308,170 options, with a fair value of \$5,729 in fiscal year 2007 for service performed in fiscal year 2006. Eligible employees were granted 353,965 options with a fair value of \$6,046 for service performed in fiscal year 2005. In accordance with APB No. 25, compensation expense associated with this grant was recorded in fiscal year 2005.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
(Dollars in thousands, except share and per share amounts)

**2. Employee Stock Plans (Continued)**

A summary of the status of the Company's stock options as of February 28, 2007, February 28, 2006, and February 28, 2005, and changes during the years ended on those dates is presented as follows:

|                                        | Shares<br>(000) | 2007<br>Weighted<br>Average<br>Exercise<br>Price | Shares<br>(000) | 2006<br>Weighted<br>Average<br>Exercise<br>Price | Shares<br>(000) | 2005<br>Weighted<br>Average<br>Exercise<br>Price |
|----------------------------------------|-----------------|--------------------------------------------------|-----------------|--------------------------------------------------|-----------------|--------------------------------------------------|
| Outstanding, beginning of year         | 3,862           | \$ 36.29                                         | 4,764           | \$ 37.08                                         | 5,041           | \$ 34.96                                         |
| Granted                                | 308             | \$ 51.31                                         | □               | □                                                | 354             | \$ 44.24                                         |
| Exercised                              | (1,305)         | \$ 33.85                                         | (849)           | \$ 40.48                                         | (605)           | \$ 27.83                                         |
| Forfeited                              | (40)            | \$ 44.18                                         | (28)            | \$ 37.51                                         | (26)            | \$ 35.95                                         |
| Expired                                | □               | □                                                | (25)            | \$ 43.06                                         | □               | □                                                |
| Outstanding, end of year               | 2,825           | \$ 38.95                                         | 3,862           | \$ 36.29                                         | 4,764           | \$ 37.08                                         |
| Treasury shares utilized for exercises | 1,305           |                                                  | 849             |                                                  | 605             |                                                  |

The Company received \$44,185 and \$34,360 in cash from the exercise of stock options during fiscal years 2007 and 2006, respectively. The total intrinsic value of options exercised during fiscal years 2007, 2006 and 2005 was \$31,955, \$5,088 and \$8,546, respectively.

The following table summarizes information about outstanding stock options at February 28, 2007:

| Range of Exercise Prices | Options Outstanding      |                                                     |                                 | Options Exercisable      |                                 |
|--------------------------|--------------------------|-----------------------------------------------------|---------------------------------|--------------------------|---------------------------------|
|                          | Number Outstanding (000) | Weighted Average Remaining Contractual Life (years) | Weighted Average Exercise Price | Number Exercisable (000) | Weighted Average Exercise Price |
| \$26-\$35                | 441                      | 6.00                                                | \$25.75                         | 441                      | \$25.75                         |
| \$36-\$40                | 1,467                    | 3.50                                                | \$38.31                         | 935                      | \$37.72                         |
| \$41-\$50                | 620                      | 5.68                                                | \$43.94                         | 288                      | \$43.60                         |
| \$51-\$55                | 297                      | 9.00                                                | \$51.31                         | □                        | □                               |
|                          | 2,825                    |                                                     |                                 | 1,664                    |                                 |

**3. Employee Profit Sharing Plans**

The Company has a defined contribution plan, the A.G. Edwards Inc. Retirement and Profit Sharing Plan (the "Retirement Plan"), covering substantially all employees, whereby the Company is obligated to make contributions, in specified amounts as defined therein, based on the compensation of eligible employees. Additional contributions may be made at the discretion of the Company and are generally based on the Company's pre-tax earnings. The Company expensed \$103,310, \$94,047 and \$77,942 in fiscal years 2007, 2006 and 2005, respectively, in connection with the Retirement Plan.

The Company has an unfunded, nonqualified deferred compensation plan, the A.G. Edwards Inc. Excess Profit Sharing Plan, that provides benefits to participants whose contributions from the Company in the Retirement Plan are subject to plan limitations. The Company expensed \$31,983, \$23,978 and \$20,095 in fiscal years 2007, 2006 and 2005, respectively, in connection with this plan. Participants may choose to base their return on the performance of one or more of a combination of mutual funds as designated by the Company, treasury securities or, in limited cases, the broker call rate. Participants have no ownership in the mutual funds or treasury securities. Included in Investments are \$153,435 and \$151,358 in fiscal years 2007 and 2006, respectively, in mutual funds that were purchased by the Company to hedge its liability to the participants that choose to base the performance of their return on the mutual fund option, with the exception of those who choose to base the performance of the return on money market mutual funds.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**4. Property and Equipment**

At February 28, 2007 and February 28, 2006, property and equipment consisted of:

|                                                 | 2007       | 2006       |
|-------------------------------------------------|------------|------------|
| Land                                            | \$ 20,042  | \$ 20,152  |
| Building and leasehold improvements             | 483,353    | 473,503    |
| Equipment and computer hardware                 | 467,621    | 476,198    |
| Software and software applications              | 215,802    | 234,970    |
| Software development in progress                | 2,260      | 1,712      |
| Construction in progress                        | 2,933      | 1,806      |
| Total property and equipment                    | 1,192,011  | 1,208,341  |
| Less: Accumulated depreciation and amortization | (728,485)  | (723,054)  |
| Total property and equipment, net               | \$ 463,526 | \$ 485,287 |

**5. Short-Term Financing**

The Company's short-term financing is generally obtained through the use of securities-lending arrangements and bank loans. The interest rates on such short-term borrowings reflect market rates of interest or rebates at the time of the transactions. The average securities-lending arrangements outstanding that were utilized in financing activities were \$179,000, \$144,000, and \$196,000 in fiscal years 2007, 2006 and 2005, respectively, at average effective interest rates of 4.2 percent, 2.9 percent and 1.4 percent in fiscal years 2007, 2006 and 2005, respectively. Customer securities were utilized in these arrangements. Bank loans are short-term borrowings that are payable on demand and may be unsecured or collateralized by customer-owned securities held in margin accounts. The average of such bank loans was \$2,000, \$28,000 and \$32,000 in fiscal years 2007, 2006 and 2005, respectively, at average effective interest rates of 5.3 percent, 3.6 percent and 1.7 percent, respectively. At February 28, 2007 and 2006, there were no outstanding short-term bank loans. At February 28, 2007, the Company, with certain limitations, had access to \$1,160,000 in uncommitted lines of credit as well as the ability to increase its securities-lending activities.



## 6. Net Capital Requirements

As a registered broker-dealer, Edwards is subject to net capital rules administered by the SEC and the New York Stock Exchange (NYSE). Under such rules, this subsidiary must maintain net capital of not less than two percent of aggregate debit items, as defined, arising from customer transactions and would be restricted from expanding its business or paying cash dividends or advancing loans to affiliates if its net capital were less than five percent of such items. These rules also require Edwards to notify and sometimes obtain approval of the NYSE and other regulatory organizations for substantial withdrawals of capital or loans to affiliates. At February 28, 2007, the subsidiary's net capital of \$784,513 was 42 percent of aggregate debit items and \$747,428 in excess of the minimum required.

Certain other subsidiaries are also subject to minimum capital requirements that may restrict the payment of cash dividends and advances to the Company. These subsidiaries have consistently operated in excess of their capital adequacy requirements. The only restriction with regard to the payment of cash dividends by the Company is its ability to obtain cash through dividends and advances from its subsidiaries, if needed.

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### A.G. Edwards, Inc.

#### Notes to Consolidated Financial Statements (Continued) Three years ended February 28, 2007 (Dollars in thousands, except share and per share amounts)

## 7. Income Taxes

The provisions (benefits) for income taxes consist of:

|                                               | 2007              | 2006<br>(As<br>Adjusted,<br>See Note 2) | 2005              |
|-----------------------------------------------|-------------------|-----------------------------------------|-------------------|
| <b>Current</b>                                |                   |                                         |                   |
| Federal                                       | \$ 170,853        | \$ 147,771                              | \$ 65,402         |
| State and local                               | 18,047            | 18,287                                  | 8,073             |
| Non-U.S.                                      | 173               | 206                                     | 456               |
|                                               | 189,073           | 166,264                                 | 73,931            |
| <b>Deferred</b>                               | 167               | (48,580)                                | 34,002            |
| <b>Cumulative effect of accounting change</b> | □                 | 1,655                                   | □                 |
|                                               | 167               | (46,925)                                | 34,002            |
|                                               | <b>\$ 189,240</b> | <b>\$ 119,339</b>                       | <b>\$ 107,933</b> |

The Company operates in multiple taxing jurisdictions, and as a result, accruals for tax contingencies require management to make estimates and judgments with respect to the ultimate tax liability in any given year. Actual results could vary from these estimates.

Deferred income taxes reflect temporary differences in the bases of the Company's assets and liabilities for income tax purposes and for financial reporting purposes, using current tax rates. These temporary differences result in taxable or deductible amounts in future years.

As of February 28, 2006, the Company adopted a plan to repatriate foreign earnings of \$3,500 attributable to a foreign subsidiary. The Company has accrued for income taxes on the repatriated earnings. All remaining earnings of the foreign subsidiary were permanently reinvested.

Significant components of deferred tax assets and liabilities at February 28, 2007, and February 28, 2006, are as follows:

|                                 | 2007       | 2006<br>(As<br>Adjusted,<br>See Note 2) |
|---------------------------------|------------|-----------------------------------------|
| <b>Deferred Tax Assets:</b>     |            |                                         |
| Employee benefits               | \$ 139,390 | \$ 145,715                              |
| Other                           | 27,430     | 21,492                                  |
|                                 | 166,820    | 167,207                                 |
| <b>Deferred Tax Liabilities</b> |            |                                         |
| Investments                     | 46,354     | 40,648                                  |
| Property and equipment          | 4,859      | 11,775                                  |
| Prepaid expenses                | 3,553      | 4,144                                   |
| Other                           | 5,107      | 3,526                                   |
|                                 | 59,873     | 60,093                                  |
|                                 | \$ 106,947 | \$ 107,114                              |

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
(Dollars in thousands, except share and per share amounts)

**7. Income Taxes (Continued)**

The Company expects to fully realize these deferred tax assets given its historical level of earnings and related taxes paid; accordingly, no valuation allowance has been established.

A reconciliation of the effective tax rate and the federal statutory rate for February 28, 2007, February 28, 2006, and February 28, 2005 is as follows:

|                                                          | 2007  | 2006<br>(As<br>Adjusted,<br>See Note 2) | 2005  |
|----------------------------------------------------------|-------|-----------------------------------------|-------|
| Federal statutory rate                                   | 35.0% | 35.0%                                   | 35.0% |
| State and local income taxes, net of federal tax benefit | 2.4   | 2.4                                     | 2.5   |
| Resolution of tax matters                                | □     | (1.9)                                   | (0.3) |
| Municipal bond interest                                  | (0.8) | (1.0)                                   | (0.7) |
| Meal and entertainment expenses                          | 0.4   | 0.4                                     | 0.5   |
| Other                                                    | (0.6) | (0.4)                                   | (0.3) |
|                                                          | 36.4% | 34.5%                                   | 36.7% |

The resolution of tax matters is primarily related to technology research and development tax credits.

**8. Investments**

Investments at February 28 consisted of:

|                            | 2007       | 2006       |
|----------------------------|------------|------------|
| Mutual funds               | \$ 186,579 | \$ 184,707 |
| Private equity             | 175,392    | 157,782    |
| U.S. government securities | 8,758      | 16,496     |
| Other                      | 35,292     | 8,837      |

|                   |            |            |
|-------------------|------------|------------|
| Total Investments | \$ 406,021 | \$ 367,822 |
|-------------------|------------|------------|

Private equity consists of investments in a privately held investment management company and in Company-sponsored private equity funds. The Company had unfunded commitments of \$30,059 to various private equity investments at February 28, 2007. A portion of the Company's mutual funds are utilized to hedge certain liabilities under its deferred compensation plan and also include qualified investments by its trust company subsidiary.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
(Dollars in thousands, except share and per share amounts)

**9. Stockholders' Equity****Earnings Per Share**

The following table presents the computations of basic and diluted earnings per share:

|                                                                           | 2007       | 2006<br>(As<br>Adjusted,<br>See Note 2) | 2005       |
|---------------------------------------------------------------------------|------------|-----------------------------------------|------------|
| Earnings before cumulative effect of accounting change                    | \$ 331,353 | \$ 223,324                              | \$ 186,474 |
| Cumulative effect of accounting change, net of<br>\$1,655 of income taxes |            | 2,768                                   |            |
| Net earnings available to common stockholders                             | \$ 331,353 | \$ 226,092                              | \$ 186,474 |
| Shares (in thousands):                                                    |            |                                         |            |
| Weighted average shares outstanding                                       | 74,636     | 76,684                                  | 77,908     |
| Dilutive effect of employee stock plan                                    | 1,795      | 520                                     | 858        |
| Total weighted average diluted shares                                     | 76,431     | 77,204                                  | 78,766     |
| Diluted earnings per share:                                               |            |                                         |            |
| Earnings before cumulative effect of accounting change                    | \$ 4.34    | \$ 2.89                                 | \$ 2.37    |
| Cumulative effect of accounting change, net of income taxes               |            | 0.04                                    |            |
| Diluted earnings per share                                                | \$ 4.34    | \$ 2.93                                 | \$ 2.37    |
| Basic earnings per share:                                                 |            |                                         |            |
| Earnings before cumulative effect of accounting change                    | \$ 4.44    | \$ 2.91                                 | \$ 2.39    |
| Cumulative effect of accounting change, net of income taxes               |            | 0.04                                    |            |
| Basic earnings per share:                                                 | \$ 4.44    | \$ 2.95                                 | \$ 2.39    |

At fiscal year-end 2007, 2006 and 2005, there were 0, 0, and 944,942 options, respectively, that were considered antidilutive and thus were not included in the above calculations.

**Stock Repurchase Program**

In November 2006, the Company's Board of Directors authorized the repurchase of up to 10,000,000 shares of the Company's outstanding stock during the period January 1, 2007, through December 31, 2008. In November 2004, the Company's Board of Directors authorized the repurchase of up to 10,000,000 shares of the Company's outstanding stock during the period November 19, 2004, through December 31, 2006. There were 6,203,611 shares repurchased by the end of the expiration period for the November 19, 2004 authorization. In November 2002, the Company's Board of Directors authorized the repurchase of up to 10,000,000 shares of the Company's

outstanding common stock during the period of January 1, 2003, through December 31, 2004. The January 1, 2003 authorization was fulfilled in its entirety. The Company purchased 3,241,865 shares at an aggregate cost of \$180,819 in 2007; 3,204,769 shares at an aggregate cost of \$141,966 in 2006; and 7,026,392 shares at an aggregate cost of \$250,123 in 2005 under these authorizations. At February 28, 2007, the Company had up to 9,419,832 shares available for repurchase under the January 2007 authorization.

In May 2005, the Company's Board of Directors authorized the repurchase of up to 5,000,000 shares of the Company's outstanding stock solely to effect employee stock transactions in the Company's Retirement and Profit Sharing Plan during the period May 24, 2005, through May 31, 2008. The Company purchased 332,437 shares at an aggregate cost of \$18,860 in 2007. The Company purchased 153,021 shares at an aggregate cost of \$6,868 during the year ended February 28, 2006. At February 28, 2007, the Company had up to 4,514,542 shares available for repurchase under this authorization.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**9. Stockholders' Equity (Continued)**

In May 2005, the Company's Board of Directors authorized the sale of up to 5,000,000 shares of the Company's stock to the Company's Retirement and Profit Sharing Plan during the period May 24, 2005 through May 31, 2008. The Company sold 372,293 shares at aggregate proceeds of \$18,026 in 2007. The Company sold 153,727 shares at aggregate proceeds of \$6,773 during the year ended February 28, 2006. At February 28, 2007, the Company had 4,473,980 shares available to sell.

**10. Commitments and Contingent Liabilities**

The Company has long-term operating leases and commitments related to office space, equipment and service agreements. Minimum commitments under all such noncancelable leases and service agreements, some of which contain escalation clauses and renewal options, at February 28, 2007, were as follows:

| <b>Year ending February 28 (29),</b> |                   |
|--------------------------------------|-------------------|
| 2008                                 | \$ 196,500        |
| 2009                                 | 135,000           |
| 2010                                 | 98,800            |
| 2011                                 | 78,000            |
| 2012                                 | 61,800            |
| Later years                          | 116,800           |
|                                      | <b>\$ 686,900</b> |

Rental expense under all operating leases and service agreements was \$210,644 in 2007, \$157,335 in 2006 and \$128,706 in 2005.

The Company accounts for operating leases in accordance with the provisions of SFAS No. 13 "Accounting for Leases," FASB Technical Bulletin 85-3 "Accounting for Operating Leases with Scheduled Rent Increases" and FASB Technical Bulletin 88-1 "Issues Relating to Accounting for Leases." As such, the costs of leasehold improvements, whether provided by the landlord or the Company, are amortized over the shorter of the lease term or the economic life of the improvement. In addition, rent escalations and lease incentives are included with the total commitment under each operating lease to calculate an average occupancy expense, which is recognized on a straight-line basis over the full lease term. Included in occupancy and equipment expenses in 2005 is a \$10,064 charge representing the cumulative effect of correcting the recognition period for rent-escalation clauses and lease incentives in certain branch-office leases. In fiscal year 2006, other expenses included a \$7,875 credit

recorded to correctly recognize state registration fees for Edwards's financial consultants over the registration period.

In the normal course of business, Edwards enters into when-issued and underwriting commitments and delayed delivery transactions. Settlement of these transactions at February 28, 2007, would not have had a material effect on the consolidated financial statements.

The Company had outstanding letters of credit of \$9,722 at February 28, 2007. At February 28, 2006, the Company had outstanding letters of credit of \$61,306 principally to satisfy margin deposit requirements with the Options Clearing Corporation.

The Company also provides guarantees to securities clearing houses and exchanges under its standard membership agreements, which require members to guarantee the performance of other members. Under these agreements, if a member becomes unable to satisfy its obligations to the clearing houses and exchanges, all other members would be required to meet any shortfall. The Company's liability under these agreements is not quantifiable and may exceed the cash and securities it has posted as collateral. However, the potential requirement for the Company to make payments under these agreements is remote. Accordingly, no liability has been recognized for these transactions.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**10. Commitments and Contingent Liabilities (Continued)**

The Company is a defendant in a number of lawsuits, in some of which plaintiffs claim substantial amounts, relating primarily to its securities and commodities business. Management has determined that it is likely that ultimate resolution in favor of the plaintiffs will result in losses to the Company on certain of these claims and as a result, establishes accruals for potential litigation losses. The Company also is involved, from time to time, in investigations and proceedings by governmental and self-regulatory agencies, certain of which may result in adverse judgments, fines or penalties. Factors considered by management in estimating the Company's reserves for these matters are the loss and damages sought by the plaintiffs, the merits of the claims, the total cost of defending the litigation, the likelihood of a successful defense against the claims, and the potential for fines and penalties from regulatory agencies. The Company establishes reserves for potential losses to the extent that such matters are probable and can be estimated, in accordance with SFAS No. 5, "Accounting for Contingencies." As litigation and the resolution of regulatory matters are inherently unpredictable, the Company cannot predict with certainty the ultimate loss or range of loss related to matters where there is only a reasonable possibility that a loss may be incurred. The Company believes, based on current knowledge and after consultation with legal counsel, that the resolution of loss contingencies will not have a material adverse effect on the consolidated balance sheet, statement of earnings or statement of cash flows of the Company. However, the outcome of such matters could be material to the Company's operating results and cash flows for future or interim periods, depending, among other things, on the results of operations for these periods.

Edwards has received information requests or subpoenas from the SEC, the NASD, the NYSE, several states and the United States Department of Justice with respect to mutual fund transactions that involve market timing, late trading or both. The SEC, the NASD and certain states have examined certain branch offices and have or will take statements from employees of Edwards in connection with such mutual fund transactions. In addition, Edwards has received requests for information concerning timing of mutual fund transactions in variable annuity sub accounts. The staff of the SEC has informed Edwards that it intends to recommend that a civil injunctive action be brought against Edwards with respect to mutual fund transactions occurring prior to October 2003 and alleged to involve market timing.

The Commonwealth of Massachusetts filed in February 2005 an administrative complaint against Edwards concerning certain mutual fund transactions in Edwards's Boston-Back Bay office. The complaint alleges violations

of securities laws by mutual fund market timing transactions and seeks a cease and desist order, an administrative fine in an unspecified amount, compensation to mutual fund holders for losses alleged to have resulted from market timing, and other relief.

The State of Illinois Secretary of State Securities Department sent a Notice of Hearing dated December 1, 2006 that alleges, among other matters, that Edwards engaged in activities to facilitate mutual fund market timing on behalf of certain clients from January 2001 to October 2003 and had inadequate procedures to detect and prevent late trading of mutual funds in violation of the Illinois Securities Law of 1953. The matter is set for hearing in May 2007. Other regulatory actions or claims may occur related to market timing or other mutual fund activities.

The Attorney General of South Carolina, Securities Division, filed an administrative proceeding in August 2005 against Edwards and two former employees in connection with actions taken from 1995 until 2002 involving securities transactions with residents of South Carolina by financial consultants in Edwards' Augusta, Georgia branch. Edwards has reached oral agreement to resolve this matter and matters relating to an Edwards branch in South Carolina by payment of \$575. In March 2004, Edwards agreed under a consent order with the Georgia Secretary of State's Securities and Business Regulation Division to make certain payments to the State of Georgia and to customers related to transactions in the Augusta, Georgia branch. Edwards has made payments in excess of \$38,200 to customers and to the State of Georgia related to these matters. Edwards believes the actions involved in these matters were isolated to one branch and a limited number of financial consultants formerly with Edwards and had no connection with any other Edwards office.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**10. Commitments and Contingent Liabilities (Continued)**

Edwards is a defendant in a complaint filed in the United States District Court for the Southern District of California that seeks to be a class action on behalf of all financial consultants and trainees who worked for Edwards in California after June 30, 2000. The action, among other relief, seeks overtime pay for financial consultants, including trainees, on the basis that the financial consultants should be classified as non-exempt employees under California law, restitution of amounts that were deducted from commissions owed to financial consultants to repay advances made in prior months, payment for meal rest breaks to which financial consultants are claimed to be entitled, and reimbursement for certain alleged business-related expenses paid by financial consultants. Several other financial services firms have been sued in California in similar actions, some of which have settled the actions for substantial amounts. Other financial firms have announced changes in compensation for and charges to financial consultants as the result of such litigation. Edwards is evaluating whether changes will be made to compensation for and charges to financial consultants. Any such changes might increase expenses for Edwards.

In addition, the Company and Edwards have been named as defendants in separate lawsuits filed in the United States District Court for the Northern District of New York, the United States District Court of New Jersey, the United States District Court for the District of Oregon, the United States District Court for the Western District of Pennsylvania, and the Court of Common Pleas of Allegheny County Pennsylvania. Each of the suits seeks to be a class action on behalf of defined groups of financial consultants or employees being trained to be financial consultants during specified periods that vary in each lawsuit. Each of the suits seeks, among other relief, overtime pay for the purported class members and two of the suits seek reimbursement of certain amounts deducted from commissions allegedly owed the employees or paid by the employees.

**11. Financial Instruments**

**Off-Balance Sheet Risk and Concentration of Credit Risk**

The Company records customer transactions on a settlement date basis, generally three business days after trade date. The risk of loss on unsettled transactions is identical to that of unpaid settled transactions and relates to customers' and other counterparties' inability to fulfill their contracted obligations.

In the normal course of business, the Company also executes customer transactions involving the sale of securities not yet purchased, the purchase and sale of futures contracts, and the writing of option contracts on both securities and futures. In the event customers or other counterparties, such as broker-dealers or clearing organizations, fail to satisfy their obligations, the Company may be required to purchase or sell financial instruments in order to fulfill its obligations at prices that may differ from amounts recorded in the consolidated balance sheets.

Customer financing and securities settlement activities generally require the Company to pledge customer securities as collateral in support of various financing sources. In addition, customer securities may be pledged as collateral to satisfy margin deposits at various clearing organizations. To the extent these counterparties are unable to fulfill their contracted obligation to return securities pledged, the Company is exposed to the risk of obtaining securities at prevailing market prices to meet its customer obligations.

Securities sold but not yet purchased represent obligations of the Company to deliver specified securities at contracted prices. Settlement of such obligations may be at amounts greater than those recorded on the consolidated balance sheets.

A substantial portion of the Company's assets and obligations result from transactions with customers and other counterparties who have provided financial instruments as collateral. Volatile trading markets could impair the value of such collateral and affect the ability of customers and other counterparties to satisfy their obligations to the Company.

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**A.G. Edwards, Inc.**

**Notes to Consolidated Financial Statements (Continued)**  
**Three years ended February 28, 2007**  
**(Dollars in thousands, except share and per share amounts)**

**11. Financial Instruments (Continued)**

The Company manages its risks associated with the aforementioned transactions through position and credit limits and the continuous monitoring of collateral. Additional collateral is requested from customers and other counterparties when appropriate.

The Company receives collateral in connection with resale agreements, securities borrowed transactions, customer margin loans and other loans. Under many agreements, the Company is permitted to sell or repledge these securities held as collateral and use these securities to enter into securities lending arrangements or to deliver to counterparties to cover short positions. At February 28, 2007, the fair value of securities received as collateral where the Company is permitted to sell or repledge the securities was \$2,394,522, and the fair value of the collateral that had been sold or repledged was \$435,768.

**Derivatives**

The Company does not act as dealer, trader or end-user of complex derivatives such as swaps, collars and caps. The Company provides advice and guidance on complex derivative products to selected clients; however, this activity does not involve the Company acquiring a position or commitment in these products. The Company will occasionally hedge a portion of its debt inventory through the use of financial futures contracts. These transactions are not material to the Company's consolidated financial condition or results of operations.

**Fair Value Consideration**

Substantially all of the Company's financial instruments are carried at fair value or amounts that approximate fair value. Customer receivables, primarily consisting of floating rate loans collateralized by margin securities, are charged interest at rates similar to other such loans made throughout the industry. The Company's remaining financial instruments are generally short-term in nature and liquidate at their carrying values.

## 12. Enterprise Wide Disclosure

The Company provides investment services to its clients through its financial consultants in its network of branch offices in the United States; London, England; and Geneva, Switzerland. Revenues from the Company's non-U.S. operations are currently not material. Transaction services include commissions and sales credits earned by executing or facilitating the execution of security and commodity trades. Asset management fees are earned by providing portfolio advisory services through third-party managers, including mutual funds, managed future funds, annuities and insurance contracts, and the Company's in-house portfolio managers. The Company earns interest revenue principally from financing its customer margin accounts, debt securities carried for resale and short-term investments.

The following table presents the Company's net revenues by type of service for the years ended February 28:

|                           | 2007         | 2006         | 2005         |
|---------------------------|--------------|--------------|--------------|
| Transaction services      | \$ 1,563,251 | \$ 1,487,597 | \$ 1,559,718 |
| Asset management services | 1,158,822    | 958,158      | 821,795      |
| Interest                  | 215,680      | 170,684      | 124,629      |
| Other                     | 172,707      | 123,674      | 101,539      |
|                           | \$ 3,110,460 | \$ 2,740,113 | \$ 2,607,681 |

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## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES.

None.

## ITEM 9A. CONTROLS AND PROCEDURES.

### *Evaluation Of Disclosure Controls And Procedures*

As of the end of the period covered by this report, the Company evaluated the effectiveness of its disclosure controls and procedures (the "Disclosure Controls"). This evaluation (the "Controls Evaluation") was performed under the supervision and with the participation of management, including the Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO").

Disclosure Controls are controls and other procedures designed to ensure that information required to be disclosed in the Company's reports filed under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), such as this Annual Report on Form 10-K, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's (the "SEC") rules and forms. Disclosure Controls are also designed to ensure that such information is accumulated and communicated to management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. The Disclosure Controls include components of the Company's internal control over financial reporting, which consist of control processes designed to provide reasonable assurance regarding the reliability of the Company's financial reporting and the preparation of financial statements in conformity with generally accepted accounting principles in the U.S. To the extent that components of the Company's internal control over financial reporting are included within the Company's Disclosure Controls, they are included in the scope of the Company's quarterly Controls Evaluation.



The Company's management, including the CEO and CFO, does not expect that the Disclosure Controls or the Company's internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

The Controls Evaluation included a review of the controls' objectives and design, the Company's implementation of the controls, and the effect of the controls on the information generated for use in this Annual Report. In the course of the Controls Evaluation, management sought to identify data errors, controls problems or acts of fraud and confirm that appropriate corrective actions, including process improvements, were being undertaken. This type of evaluation is performed on a quarterly basis so that the conclusions of management, including the CEO and CFO, concerning the effectiveness of the Disclosure Controls can be reported in the Company's Quarterly Reports on Form 10-Q and Annual Report on Form 10-K. Many of the components of the Company's Disclosure Controls are also evaluated on an ongoing basis by the Internal Audit Department and by other personnel of the Company who evaluate them in connection with determining their auditing procedures. The overall goals of these various evaluation activities are to monitor Disclosure Controls and to modify them as necessary. The Company intends to maintain the Disclosure Controls as dynamic systems that change as conditions warrant.

Based upon the Controls Evaluation, the CEO and CFO have concluded that as of the end of the period covered by this Annual Report, the Disclosure Controls were effective to provide reasonable assurance that information required to be disclosed in the Company's reports filed under the Exchange Act is recorded,

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processed, summarized and reported within the time periods specified by the SEC and that material information relating to the Company and its consolidated subsidiaries required to be disclosed in such reports is made known to management, including the CEO and CFO, particularly during the period when the periodic reports are being prepared.

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

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)).

Management assessed the effectiveness of the Company's internal control over financial reporting as of February 28, 2007. In making this assessment Company management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") *Internal Control - Integrated Framework*. Management has concluded that, as of February 28, 2007, the Company's internal control over financial reporting was effective based on those criteria.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

The Company's independent registered public accounting firm audited management's assessment of the effectiveness of the Company's internal control over financial reporting as of February 28, 2007. As stated in their attestation report appearing on the following page, Deloitte & Touche LLP expresses an unqualified opinion on

management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting as of February 28, 2007.

April 27, 2007

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of  
A.G. Edwards, Inc.  
St. Louis, Missouri

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that A.G. Edwards, Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of February 28, 2007, based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed by, or under the supervision of, the company's principal executive and principal financial officers, or persons performing similar functions, and effected by the company's board of directors, management, and other personnel 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 (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) 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 (3) 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 the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of February 28, 2007, is fairly stated, in all material respects, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of February 28, 2007, based on the criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements and financial statement schedule as of and for the year ended February 28, 2007 of the Company and our report dated April 27, 2007 expressed an unqualified opinion on those consolidated financial statements and financial statement schedule and included an explanatory paragraph regarding the Company's change in its accounting policy for the recognition of equity awards granted to retirement-eligible employees and the retrospective adjustment to the fiscal year 2006 consolidated financial statements for the change.

/s/ Deloitte & Touche LLP  
St. Louis, Missouri  
April 27, 2007

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## **CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

No change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) occurred during the fiscal quarter ended February 28, 2007 that has materially affected, or is reasonable likely to materially affect, the Company's internal control over financial reporting.

### **ITEM 9B. OTHER INFORMATION.**

None.

## **PART III**

### **ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.**

The information required by this item will be included under the caption "Election of Directors" Nominees for Directors" in the Company's 2007 Proxy Statement and under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" in the Company's 2007 Proxy Statement, and such information is hereby incorporated by reference and in Part I of this Form's 10-K under the caption "Executive Officers of the Company."

Information relating to the Board of Directors' determination regarding the service of an audit committee financial expert on the Board's Audit Committee and the name and the determination by the Board of the independence of such expert will be set forth under the caption "Committees and Meetings of the Board of Directors - Audit Committee," in the Company's 2007 Proxy Statement and is incorporated by reference. Information relating to the identity of the members of the Board's Audit Committee will also be set forth under this caption and is incorporated by reference. The information regarding the procedures by which shareholders may recommend nominees to the Board of Directors will be set forth in the Company's 2007 Proxy Statement under the caption titled "Stockholder Proposals."

The Company's Code of Ethical Conduct ("Code") for all Directors, Officers and Employees and Corporate Governance Guidelines ("Guidelines") set forth the fundamental principles and key policies and procedures that govern the conduct of all of the Company's directors, officers and employees. Additionally, the Chief Executive Officer, Chief Financial Officer, Principal Accounting Officer, Controller, Director of Enterprise Risk Management and Regulatory Reports and Director of Tax ("Senior Financial Officers") are required to conduct their personal and professional affairs in a manner that is consistent with the ethical and professional standards set forth in the Company's Financial Code of Ethical Conduct for Senior Financial Officers ("Financial Code"). A copy of the Code and the Financial Code were filed as exhibits 14.1 and 14.2, respectively, in the Company's Annual Report on Form 10-K for the 2004 fiscal year and is also available on the Company's web site at [www.agedwards.com](http://www.agedwards.com) and may be accessed by entering the Company's web site and clicking the "About A.G. Edwards" link, then the "Corporate Governance" link. The Company will post on its web site any amendments to the Code, Financial Code and/or Guidelines and any waivers that are required to be disclosed by the rules of the SEC or NYSE.

The Company has included as exhibits to this Annual Report on Form 10-K for the 2007 fiscal year filed with the SEC certificates of its Chief Executive Officer and Chief Financial Officer certifying the quality of the Company's public disclosure. The Company submitted to the NYSE as of July 12, 2006, a certification made by its

Chief Executive Officer that he is not aware of any violation by the Company of their corporate governance listing standards.

#### **ITEM 11. EXECUTIVE COMPENSATION.**

The information contained under the caption titled "Compensation" (from the section titled "Director Compensation" through the section titled "Compensation Committee Interlocks and Insider Participation") in the Company's 2007 Proxy Statement is incorporated by reference under this item.

#### **ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.**

The information contained in the Company's 2007 Proxy Statement under the caption titled "Beneficial Ownership of the Company's Common Stock," and "Equity Compensation Plans" is incorporated by reference under this item.

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#### **ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.**

The information contained in the Company's 2007 Proxy Statement under the captions titled "Certain Transactions" and "Committees and Meetings of the Board of Directors - Independent Directors," is incorporated by reference under this item.

#### **ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES.**

The information contained in the Company's 2007 Proxy Statement under the captions titled "Pre-Approval of Services Provided by the Company's Independent Registered Public Accounting Firm" and "Principal Accounting Firm Fees" is incorporated by reference under this item.

### **PART IV**

#### **ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.**

| INDEX                                                            | PAGE<br>NUMBER |
|------------------------------------------------------------------|----------------|
| (a) 1. Financial Statements                                      |                |
| Management's Report on Internal Control Over Financial Reporting | 62             |
| Reports of Independent Registered Public Accounting Firm         | 36 and 63      |
| Consolidated balance sheets                                      | 37             |
| Consolidated statements of earnings                              | 38             |
| Consolidated statements of stockholders' equity                  | 39             |
| Consolidated statements of cash flows                            | 40             |
| Notes to consolidated financial statements                       | 41             |
| 2. Financial Statement Schedules                                 |                |
| Schedule II - Valuation and Qualifying Accounts                  | 69             |

All other schedules are omitted due to the absence of conditions under which they are required or because the required information is provided in the consolidated financial statements or notes thereto.

#### 3. Exhibits\*

Some of the following exhibits were previously filed as exhibits to other reports or registration statements filed by the Company and are incorporated by reference as indicated below.

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- 3(i) Certificate of Incorporation filed as Exhibit 3(i) to the Registrant's Form 10-K for the fiscal year ended February 28, 1993, as amended by the Certificate of Amendment of Certificate of Incorporation filed as Exhibit 3(i)(a) to the Registrant's Form 10-Q for the fiscal quarter ended May 31, 1998.
- 3(ii) By laws, as amended, filed as Exhibit 3(ii) to the Registrant's Form 10-K for the fiscal year ended February 28, 1994.
- 4(i) Reference is made to Articles IV, V, X, XII, XIII and XV of the Certificate of Incorporation filed as Exhibit 3(i) to this Form 10-K.
- 4(ii) Reference is made to Article II, Article III Sections 1 and 15, Article IV Sections 1 and 3, Article VI and Article VII Sections 1-3 of the By laws filed as Exhibit 3(ii) to this Form 10-K.
- 10.1 A.G. Edwards, Inc. 1988 Incentive Stock Plan (2005 Restatement and First Amendment) filed as Exhibit 10.1 to Registrant's Form 10-K for the fiscal year ended February 28, 2006.\*\*
- 10.2 A.G. Edwards, Inc. Non Employee Director Stock Compensation Plan (as amended and restated) filed as Exhibit 10 to Registrant's Form 10-Q for the fiscal quarter ended May 31, 2005.\*\*
- 10.3 A.G. Edwards, Inc. Retirement and Profit Sharing Plan (2005 Restatement and Amendments) filed as Exhibit 10 to Registrant's Form 10-Q for the fiscal quarter ended November 30, 2006.\*\*
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- 10.4 A.G. Edwards, Inc. Corporate Executive Bonus Plan filed as Exhibit 10.4 to Registrant's Form 10-K for the fiscal year ended February 28, 2005.\*\*
- 10.5 A.G. Edwards, Inc. 2004 Performance Plan for Executives filed as Exhibit 10.5 to Registrant's Form 8-K dated March 1, 2005.\*\*
- 10.6 A.G. Edwards, Inc. Excess Profit Sharing Plan filed as Exhibit 10.4 to Registrant's Form 8-K dated March 1, 2005.\*\*
- 10.7 Hosting and Services Agreement between A.G. Edwards Technology Group, Inc. and BETA Systems, a division of Thomson Financial Inc. filed as Exhibit 10 to Registrant's Form 10-Q for the fiscal quarter ended November 30, 2004.
- 11 Computation of per share earnings is set forth in Note 9 (Stockholders' Equity) of the Notes to Consolidated Financial Statements under the caption "Earnings Per Share" in this Form 10-K.
- 14.1 A.G. Edwards, Inc. Code of Ethical Conduct filed as Exhibit 14.1 to Registrant's Form 10-K for the fiscal year ended February 29, 2004.
- 14.2 A.G. Edwards, Inc. Financial Code of Ethical Conduct filed as Exhibit 14.2 to Registrant's Form 10-K for the fiscal year ended February 29, 2004.
- 18 Preferability Letter from Independent Registered Public Accounting Firm filed as Exhibit 18 to Registrant's Form 10-Q for the fiscal quarter ended May 31, 2006.

|      |                                                                                    |
|------|------------------------------------------------------------------------------------|
| 21   | Registrant's Subsidiaries.                                                         |
| 23   | Consent of Independent Registered Public Accounting Firm.                          |
| 24   | Power of Attorney (included on the signature page of this Form 10-K).              |
| 31.1 | Principal Executive Officer Certification as required by Rule 13a-14(a)/15d-14(a). |
| 31.2 | Principal Financial Officer Certification as required by Rule 13a-14(a)/15d-14(a). |
| 32.1 | Principal Executive Officer Certification Pursuant to 18 U.S.C. Section 1350.      |
| 32.2 | Principal Financial Officer Certification Pursuant to 18 U.S.C. Section 1350.      |

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\* Numbers correspond to document numbers in the Exhibit Table of Item 601 of Regulation S-K.

\*\* Compensatory plan or arrangement under which executive officers or directors of the Company may participate.

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### 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.

A.G. EDWARDS, INC.  
(Registrant)

Date: April 27, 2007

By /s/ Robert L. Bagby  
Robert L. Bagby  
Chairman of the Board, President and  
Chief Executive Officer

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### POWER OF ATTORNEY

KNOW ALL MEN BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Robert L. Bagby, and Douglas L. Kelly and each of them, his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him or her and in his or her name, place and stead, in any and all capacities, to sign this Report, any and all amendments to this Report, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done, as fully to all intents and purposes as he or she might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents or either of them, or their, her or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

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.

|                                                             |                                                                    |                |
|-------------------------------------------------------------|--------------------------------------------------------------------|----------------|
| /s/ Robert L. Bagby<br>Robert L. Bagby                      | Chairman of the Board,<br>Chief Executive Officer and<br>President | April 18, 2007 |
| /s/ Ronald J. Kessler<br>Ronald J. Kessler                  | Vice Chairman of the Board                                         | April 18, 2007 |
| /s/ E. Eugene Carter<br>E. Eugene Carter                    | Director                                                           | April 18, 2007 |
| /s/ Vicki B. Escarra<br>Vicki B. Escarra                    | Director                                                           | April 18, 2007 |
| /s/ Samuel C. Hutchinson<br>Jr.<br>Samuel C. Hutchinson Jr. | Director                                                           | April 18, 2007 |
| /s/ Peter B. Madoff<br>Peter B. Madoff                      | Director                                                           | April 18, 2007 |
| /s/ Mark S. Wrighton<br>Mark S. Wrighton                    | Director                                                           | April 18, 2007 |
| /s/ Douglas L. Kelly<br>Douglas L. Kelly                    | Treasurer, Chief Financial Officer<br>and Secretary                | April 18, 2007 |
| /s/ Joseph G. Porter<br>Joseph G. Porter                    | Principal Accounting Officer                                       | April 18, 2007 |

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**SCHEDULE II □ VALUATION AND QUALIFYING ACCOUNTS**
**A.G. EDWARDS, INC.  
(Dollars in thousands)**

| <b>Description</b>              | <b>Balance at<br/>Beginning<br/>of Period</b> | <b>Additions<br/>Charged to<br/>Costs and<br/>Expenses</b> | <b>Deductions*</b> | <b>Balance<br/>at End<br/>of Period</b> |
|---------------------------------|-----------------------------------------------|------------------------------------------------------------|--------------------|-----------------------------------------|
| Year ended February 28, 2007    |                                               |                                                            |                    |                                         |
| Deducted from asset account:    |                                               |                                                            |                    |                                         |
| Allowance for doubtful accounts | \$ 2,600                                      | \$ 1,078                                                   | \$ 978             | \$2,700                                 |
| Year ended February 28, 2006    |                                               |                                                            |                    |                                         |
| Deducted from asset account:    |                                               |                                                            |                    |                                         |
| Allowance for doubtful accounts | \$ 8,045                                      | \$ 680                                                     | \$ 6,125           | \$2,600                                 |
| Year ended February 28, 2005    |                                               |                                                            |                    |                                         |
| Deducted from asset account:    |                                               |                                                            |                    |                                         |
| Allowance for doubtful accounts | \$ 45,593                                     | \$ 2,262                                                   | \$ 39,810          | \$8,045                                 |

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(\*) Write-offs net of recoveries.

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**EXHIBIT INDEX**

| <b>Exhibit</b> | <b>Description</b>                                                                                                                                |
|----------------|---------------------------------------------------------------------------------------------------------------------------------------------------|
| 21             | Registrant's Subsidiaries                                                                                                                         |
| 23             | Consent of Independent Registered Public Accounting Firm                                                                                          |
| 24             | Power of Attorney (included on signature page of this Form 10-K)                                                                                  |
| 31.1           | Principal Executive Officer Certification as required by Rule 13a-14(a)/15d-14(a)                                                                 |
| 31.2           | Principal Financial Officer Certification as required by Rule 13a-14(a)/15d-14(a)                                                                 |
| 32.1           | Principal Executive Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2           | Principal Financial Officer Certification Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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