

MARKETAXESS HOLDINGS INC

Form 10-Q

May 10, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

**(Mark One)**

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

**For the quarterly period ended March 31, 2007**

**or**

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

**For the transition period from** \_\_\_\_\_ **to** \_\_\_\_\_

**Commission File Number 0-50670  
MARKETAXESS HOLDINGS INC.**

*(Exact name of registrant as specified in its charter)*

**Delaware**

*(State of incorporation)*

**52-2230784**

*(IRS Employer Identification No.)*

**140 Broadway, 42nd Floor New York, New York**

*(Address of principal executive offices)*

**10005**

*(Zip Code)*

**(212) 813-6000**

**(Registrant's telephone number, including area code)**

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

Indicate by check mark whether the registrant 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):

Large accelerated filer  Accelerated Filer  Non-accelerated filer

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

At May 9, 2007, the number of shares of the Registrant's voting common stock outstanding was 31,047,181 and the number of shares of the Registrant's non-voting common stock was 2,585,654.

**MARKETAXESS HOLDINGS INC.**  
**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2007**  
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**Table of Contents****PART I Financial Information****Item 1. Financial Statements**

**MARKETAXESS HOLDINGS INC.**  
**CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION**  
**(Unaudited)**

	<b>March 31, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands, except share and per share amounts)</b>	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 68,291	\$ 82,000
Securities and cash provided as collateral	3,765	3,798
Securities available-for-sale	44,438	49,015
Accounts receivable, including receivables from related parties of \$6,688 and \$8,579, respectively, net of allowance of \$681 and \$752 as of March 31, 2007 and December 31, 2006, respectively	19,998	17,429
Furniture, equipment and leasehold improvements, net of accumulated depreciation and amortization	3,896	4,304
Software development costs, net of amortization	6,357	6,610
Prepaid expenses and other assets	2,103	2,221
Deferred tax assets, net	40,326	38,901
<b>Total assets</b>	<b>\$ 189,174</b>	<b>\$ 204,278</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Liabilities		
Accrued employee compensation	\$ 5,412	\$ 12,813
Deferred revenue	952	857
Accounts payable, accrued expenses, and other liabilities, including payables to a related party of \$59 and \$110 as of March 31, 2007 and December 31, 2006, respectively	8,464	5,323
<b>Total liabilities</b>	<b>14,828</b>	<b>18,993</b>
<b>Commitments and Contingencies (Note 12)</b>		
<b>Stockholders equity</b>		
Preferred stock, \$0.001 par value, 5,000,000 shares authorized and 0 shares issued and outstanding as of March 31, 2007 and December 31, 2006		
Common stock voting, \$0.003 par value, 110,000,000 shares authorized as of March 31, 2007 and December 31, 2006; 29,969,460 shares and 29,409,537 shares issued as of March 31, 2007 and December 31, 2006, respectively	90	88
Common stock non-voting, \$0.003 par value, 10,000,000 authorized as of March 31, 2007 and December 31, 2006; 3,125,379 shares issued and outstanding as of March 31, 2007 and December 31, 2006	11	11

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Warrants, 2,198,391 and 2,379,396 authorized, issued and outstanding as of March 31, 2007 and December 31, 2006, respectively	10,776	11,658
Additional paid-in capital	271,101	265,030
Receivable for common stock subscribed	(1,042)	(1,042)
Treasury stock Common stock voting, at cost, 1,592,657 shares and 190,500 shares as of March 31, 2007 and December 31, 2006, respectively	(21,192)	(2,653)
Accumulated deficit	(84,624)	(87,074)
Accumulated other comprehensive loss	(774)	(733)
<b>Total stockholders equity</b>	174,346	185,285
<b>Total liabilities and stockholders equity</b>	\$ 189,174	\$ 204,278

The accompanying notes are an integral part of these consolidated financial statements.

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**MARKETAXESS HOLDINGS INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(In thousands, except share and per share amounts)</b>	
<b>Revenues</b>		
Commissions		
U.S. high-grade, including \$5,964 and \$5,553 from related parties for the three months ended March 31, 2007 and 2006, respectively	\$ 13,682	\$ 11,029
European high-grade, including \$1,355 and \$1,878 from related parties for the three months ended March 31, 2007 and 2006, respectively	4,754	4,338
Other, including \$1,259 and \$1,388 from related parties for the three months ended March 31, 2007 and 2006, respectively	2,257	2,120
<b>Total commissions</b>	<b>20,693</b>	<b>17,487</b>
Information and user access fees, including \$186 and \$270 from related parties for the three months ended March 31, 2007 and 2006, respectively	1,354	1,359
License fees	239	281
Investment income, including \$528 and \$214 from related parties for the three months ended March 31, 2007 and 2006, respectively	1,222	962
Other, including \$102 and \$134 from related parties for the three months ended March 31, 2007 and 2006, respectively	257	251
<b>Total revenues</b>	<b>23,765</b>	<b>20,340</b>
<b>Expenses</b>		
Employee compensation and benefits	11,503	10,283
Depreciation and amortization	1,911	1,685
Technology and communications	1,763	2,052
Professional and consulting fees	1,836	2,551
Occupancy	749	830
Marketing and advertising	353	378
General and administrative, including \$13 and \$15 to related parties for the three months ended March 31, 2007 and 2006, respectively	1,181	1,162
<b>Total expenses</b>	<b>19,296</b>	<b>18,941</b>
Income before income taxes	4,469	1,399
Provision for income taxes	2,019	313
<b>Net income</b>	<b>\$ 2,450</b>	<b>\$ 1,086</b>

Net income per common share				
Basic	\$	0.08	\$	0.04
Diluted	\$	0.07	\$	0.03
Weighted average shares used to compute net income per common share				
Basic		30,813,478		29,814,296
Diluted		34,526,548		35,672,980

The accompanying notes are an integral part of these consolidated financial statements.

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**MARKETAXESS HOLDINGS INC.**  
**CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY AND ACCUMULATED**  
**OTHER COMPREHENSIVE (LOSS)**  
**(Unaudited)**

	Common		Treasury Stock	Receivable for Common Stock Subscribed	Common Stock Voting	Accumulated Deficit	Other Comprehensive (Loss)	Total Stockholders Equity	
	Common Stock Voting	Non- Voting Warrants							
Balance at December 31, 2006	\$88	\$11	\$11,658	\$265,030	\$(1,042)	\$ (2,653)	\$(87,074)	\$ (733)	\$185,285
Comprehensive income:									
Net income						2,450			2,450
Cumulative translation adjustment and foreign currency exchange hedge, net of tax								(41)	(41)
Total comprehensive income									2,409
Effect of adoption of FIN 48				324					324
Stock based compensation				1,596					1,596
Issuance of common stock related to exercise of stock options and grants of restricted stock	1			2,566	1				2,567
Excess tax benefit from stock based compensation				704					704
Exercise of warrants	1		(882)	881					
Purchase of treasury stock									(18,539)



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Balance at  
March 31, 2007    \$90    \$11    \$10,776    \$271,101    \$(1,042)    \$(21,192)    \$(84,624)    \$(774)    \$174,346

The accompanying notes are an integral part of these consolidated financial statements.

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**MARKETAXESS HOLDINGS INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**

	<b>Three Months Ended March</b>	
	<b>31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
<b>Cash flows from operating activities</b>		
Net income	\$ 2,450	\$ 1,086
Adjustments to reconcile net income to net cash (used in) operating activities:	1,911	1,685
Depreciation and amortization		
Stock based compensation expense	1,596	1,960
Deferred taxes	1,599	(448)
Provision for bad debts	79	43
Changes in operating assets and liabilities:		
(Increase) in accounts receivable, including decrease (increase) of \$1,891 and (\$195) from related parties for the three months ended March 31, 2007 and 2006, respectively	(2,648)	(1,113)
Decrease in prepaid expenses and other assets	118	1,280
(Decrease) in accrued employee compensation	(7,401)	(9,011)
Increase (decrease) in deferred revenue	95	(274)
Increase (decrease) in accounts payable, accrued expenses and other liabilities, including (decrease) of (\$51) and (\$3) to related parties for the three months ended March 31, 2007 and 2006	441	(27)
<b>Net cash (used in) operating activities</b>	<b>(1,760)</b>	<b>(4,819)</b>
<b>Cash flows from investing activities</b>		
Securities available-for-sale:		
Proceeds from sales	11,305	12,200
Purchases	(6,728)	(12,293)
Securities and cash provided as collateral	33	35
Purchases of furniture, equipment and leasehold improvements	(348)	(1,089)
Capitalization of software development costs	(900)	(1,350)
<b>Net cash provided by (used in) investing activities</b>	<b>3,362</b>	<b>(2,497)</b>
<b>Cash flows from financing activities</b>		
Proceeds from the exercise of stock options and issuance of restricted stock	2,567	634
Excess tax benefits from stock based compensation	704	613
Purchase of treasury stock common stock voting	(18,539)	
<b>Net cash (used in) provided by financing activities</b>	<b>(15,268)</b>	<b>1,247</b>
<b>Effect of exchange rate changes on cash</b>	<b>(43)</b>	<b>38</b>
<b>Cash and cash equivalents</b>		
Net (decrease) for the period	(13,709)	(6,031)

Beginning of year	82,000	58,189
<b>End of year</b>	<b>\$ 68,291</b>	<b>\$ 52,158</b>

**Supplemental cash flow information:****Cash paid during the year:**

Income taxes paid	\$ 40	\$ 88
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**Non-cash activity:**

Non-cash exercise of warrants and issuance of common stock	\$ 882	\$
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The accompanying notes are an integral part of these consolidated financial statements.

**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited****1. Organization and Principal Business Activity**

MarketAxess Holdings Inc. (the Company) was incorporated in the State of Delaware on April 11, 2000. Through its subsidiaries, the Company operates an electronic trading platform for corporate bonds and certain other types of fixed-income securities, through which the Company's active institutional investor clients can access the liquidity provided by its broker-dealer clients. The Company's multi-dealer trading platform allows its institutional investor clients to simultaneously request competitive, executable bids or offers from multiple broker-dealers, and to execute trades with the broker-dealer of their choice. The Company offers its clients the ability to trade U.S. high-grade corporate bonds, European high-grade corporate bonds, credit default swaps, agencies, high yield and emerging markets bonds. The Company's DealerAxess® trading service allows dealers to trade fixed-income securities with each other on its platform. The Company also provides data and analytical tools that help its clients make trading decisions and facilitates the trading process by electronically communicating order information between trading counterparties. The Company's current participating dealers are: ABN AMRO, Banc of America Securities, Barclays PLC, Bear Stearns, BNP Paribas, Calyon, Citigroup Global Markets, Credit Suisse, Deutsche Bank Securities, Dresdner Bank AG, DZ Bank AG, FTN Financial, Goldman Sachs, HSBC, ING Financial Markets, JPMorgan, Jefferies and Company, Lehman Brothers, Merrill Lynch, Morgan Stanley, RBC Capital Markets, The Royal Bank of Scotland, Santander Investment Securities, SG Corporate & Investment Banking, UBS and Wachovia Securities.

The Company's stockholder broker-dealer clients as of January 1, 2007 were Banc of America Securities, Bear Stearns, BNP Paribas, Credit Suisse, JPMorgan, Lehman Brothers and UBS. All of these broker-dealer clients constitute related parties of the Company (together, the Stockholder Broker-Dealer Clients). For 2006, a total of nine dealers were considered to be Stockholder Broker-Dealer Clients. See Note 8, Related Parties.

The Company's U.S. subsidiary, MarketAxess Corporation, is a registered broker-dealer with the U.S. Securities and Exchange Commission (SEC) and is a member of the National Association of Securities Dealers, Inc. (NASD). The Company also has three international subsidiaries: MarketAxess Europe Limited (MarketAxess Europe), which is registered as an Alternative Trading System dealer with the Financial Services Authority (FSA) in the United Kingdom (U.K.); MarketAxess Leasing Limited (collectively with MarketAxess Europe, the U.K. Subsidiaries); and MarketAxess Canada Limited, a Canadian subsidiary. MarketAxess Canada Limited has applied for registration as an Alternative Trading System dealer under the Securities Act of Ontario and is in the process of seeking approval for membership with the Investment Dealers Association of Canada.

**2. Significant Accounting Policies*****Basis of Presentation***

The Consolidated Financial Statements include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated.

These Consolidated Financial Statements are unaudited and should be read in conjunction with the audited Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006. The consolidated financial information as of December 31, 2006 has been derived from audited financial statements not included herein.

These unaudited Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States and the rules and regulations of the SEC with respect to Form 10-Q and reflect all adjustments that, in the opinion of management, are normal and recurring, and which are necessary for a fair statement of the results for the interim periods presented. In accordance with such rules and regulations, certain disclosures that are normally included in annual financial statements have been omitted. Interim period operating results may not be indicative of the operating results for a full year.

***Cash and Cash Equivalents***

Cash and cash equivalents include cash maintained at U.S. and U.K. banks and in money market funds. The Company defines cash equivalents as short-term interest-bearing investments with maturities at the time of purchase of three months or less.



**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)*****Securities and Cash Provided as Collateral***

Securities provided as collateral consist of U.S. government obligations and cash. Collectively, these amounts are used as collateral for standby letters of credit, as collateral for foreign currency forward contracts to hedge the Company's net investments in the U.K. Subsidiaries and as collateral for a broker-dealer clearance account.

***Securities Available-for-Sale***

The Company classifies its marketable securities as Available-for-sale securities. Unrealized marketable securities gains and losses are reflected as a net amount under the caption of Accumulated other comprehensive loss on the Consolidated Statements of Financial Condition. Realized gains and losses are recorded on the Consolidated Statements of Operations in Other revenues. For the purpose of computing realized gains and losses, cost is determined on a specific identification basis.

The Company assesses whether an other-than-temporary impairment loss on the investments has occurred due to declines in fair value or other market conditions. Declines in fair values that are considered other-than-temporary are recorded as charges in the Consolidated Statements of Operations.

***Allowance for Doubtful Accounts***

The Company continually monitors collections and payments from its clients and maintains an allowance for doubtful accounts. The allowance for doubtful accounts is based upon the historical collection experience and specific collection issues that have been identified. Additions to the allowance for doubtful accounts are charged to bad debt expense, which is included in General and administrative expense in the Company's Consolidated Statements of Operations.

***Depreciation and Amortization***

Fixed assets are carried at cost less accumulated depreciation. The Company uses the straight-line method of depreciation over three years.

Leasehold improvements are stated at cost and are amortized using the straight-line method over the lesser of the life of the improvement or the remaining term of the lease.

***Software Development Costs***

In accordance with Statement of Position No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, the Company capitalizes certain costs associated with the development of internal use software at the point at which the conceptual formulation, design and testing of possible software project alternatives have been completed. The Company capitalizes employee compensation and related benefits and third party consulting costs incurred during the preliminary software project stage. Once the product is ready for its intended use, such costs are amortized on a straight-line basis over three years. The Company reviews the amounts capitalized for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable.

***Revenue Recognition***

The majority of the Company's revenues are derived from commissions for trades executed on its platform that are billed to its broker-dealer clients on a monthly basis. Commissions are generally calculated as a percentage of the notional dollar volume of bonds traded on the platform and vary based on the type and maturity of the bond traded. Under the Company's transaction fee plans, bonds that are more actively traded or that have shorter maturities are generally charged lower commissions, while bonds that are less actively traded or that have longer maturities generally command higher commissions.

The Company also derives revenues from information and user access fees, license fees, investment income and other income.

The Company enters into agreements with its broker-dealer clients pursuant to which the Company provides access to its platform through a non-exclusive and non-transferable license. Broker-dealer clients, other than those that previously made equity investments in the Company, pay an initial license fee, which is typically due and payable upon execution of the broker-dealer agreement. The initial license fee varies by agreement and at a minimum is intended to cover the initial set-up costs incurred to enable a broker-dealer to begin using the Company's electronic

trading platform. Revenue is recognized in the first three months of the agreement in the estimated amount of the set-up costs incurred (50% in the first month, 40% in the second month and 10% in the third month), and the

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**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)**

remaining amount is deferred and recognized ratably over the initial term of the agreement, which is generally three years. The Company anticipates that license fees will be a less material source of revenues on a going-forward basis.

***Stock-Based Compensation for Employees***

The Company measures and recognizes compensation expense for all share-based payment awards made to employees in accordance with Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 123 (revised 2004), Share-Based Payment ( SFAS 123R ). This statement requires that compensation expense for all share-based awards be recognized based on their estimated fair values measured as of the grant date. These costs are recognized as an expense in the Consolidated Statements of Operations over the requisite service period, which is typically the vesting period, with an offsetting increase to Additional paid-in capital. The Company adopted SFAS 123R using the modified prospective transition method, which required the application of the accounting standard as of January 1, 2006.

***Income Taxes***

Income taxes are accounted for using the asset and liability method in accordance with SFAS No. 109, Accounting for Income Taxes ( SFAS 109 ). Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized against deferred tax assets if it is more likely than not that such assets will not be realized in future years.

***Foreign Currency Translation and Forward Contracts***

Assets and liabilities denominated in foreign currencies are translated using exchange rates at the end of the period; revenues and expenses are translated at average monthly rates. Gains and losses on foreign currency translation are a component of Accumulated other comprehensive loss on the Consolidated Statements of Financial Condition. Transaction gains and losses are recorded in General and administrative expense.

The Company enters into foreign currency forward contracts to hedge its net investment in the U.K. Subsidiaries. In accordance with SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, gains and losses on these transactions are deferred and included in Accumulated other comprehensive loss on the Consolidated Statements of Financial Condition.

***Earnings Per Share***

SFAS No. 128, Earnings Per Share, requires the presentation of basic and diluted earnings per share ( EPS ) in the Consolidated Statements of Operations. Basic EPS is computed by dividing the net income attributable to common stock by the weighted-average number of shares of common stock outstanding for the period. Diluted EPS is computed using the same method as basic EPS, but in the denominator, shares of common stock outstanding reflect the dilutive effect that could occur if convertible securities or other contracts to issue common stock were converted into or exercised for common stock.

***Use of Estimates***

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

***Recent Accounting Pronouncements***

In February 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments ( SFAS 155 ). SFAS 155 is an amendment of SFAS No. 133 and SFAS No. 140. SFAS 155 permits companies to elect, on a deal-by-deal basis, to apply a fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. Adoption of SFAS 155 did not affect the Company's Consolidated Financial Statements.





**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)**

In March 2006, the FASB issued SFAS No. 156, Accounting for Servicing of Financial Assets ( SFAS 156 ). SFAS 156 amends SFAS No. 140. SFAS 156 requires that all separately recognized servicing assets and servicing liabilities be initially measured at fair value. For subsequent measurements, SFAS 156 permits companies to choose between an amortization method or a fair value measurement method for reporting purposes. SFAS 156 is effective as of the beginning of a company's first fiscal year that begins after September 15, 2006. Adoption of SFAS 156 did not affect the Company's 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 ) which applies to all tax positions accounted for under SFAS 109. A tax position includes current or future reductions in taxable income reported or expected to be reported on a tax return. FIN 48 supplements SFAS 109 by defining the confidence level that a tax position must meet in order to be recognized in the financial statements. The interpretation requires that the tax effects of a position be recognized only if it is more-likely-than-not (greater than 50% likelihood) to be sustained based solely on its technical merits as of the reporting date. In making this assessment, a company must assume that the taxing authorities will examine the position. As a result of the implementation of FIN 48 effective January 1, 2007, the Company recognized an increase in deferred tax assets of \$3.0 million related to previously unrecognized tax benefits, which was accounted for as an increase to Additional paid-in capital of \$0.3 million and an increase in accrued expenses of \$2.7 million. See Note 7, Income Taxes.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. The Company does not expect SFAS 157 to have a material impact on its Consolidated Financial Statements.

In February 2007, the FASB issued SFAS No. 159, Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 permits companies to elect to measure eligible financial instruments, commitments and certain other arrangements at fair value at specified election dates, with changes in fair value recognized in earnings at each subsequent reporting period. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company does not expect SFAS 159 to have a material impact on its Consolidated Financial Statements.

**Reclassifications**

Certain reclassifications have been made to the prior periods' financial statements in order to conform to the current period's presentation. Such reclassifications had no effect on previously reported Net income.

**3. Net Capital Requirements and Customer Protection Requirements**

The Company's U.S. subsidiary, MarketAxess Corporation, maintains a registration as a U.S. securities broker-dealer. Pursuant to the Uniform Net Capital Rule under the Securities Exchange Act of 1934, MarketAxess Corporation is required to maintain minimum net capital, as defined, equal to the greater of \$5 thousand or 6 2/3% of aggregate indebtedness. A summary of MarketAxess Corporation's capital requirements is as follows:

	<b>March 31, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Net capital	\$ 7,326	\$ 14,982
Required net capital	(601)	(1,048)
Excess net capital	\$ 6,725	\$ 13,934
Ratio of aggregate indebtedness to net capital	1.23 to 1	1.05 to 1

MarketAxess Corporation claims exemption from SEC Rule 15c3-3, as it does not hold customer securities or funds on account, as defined.



**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)**

MarketAxess Europe is subject to certain financial resource requirements of the FSA. A summary of these financial resource requirements is as follows:

	<b>March 31, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Financial resources	\$ 16,848	\$ 14,882
Resource requirement	(8,230)	(4,372)
Excess financial resources	\$ 8,618	\$ 10,510

MarketAxess Corporation and MarketAxess Europe are subject to U.S. and U.K. regulations as a registered broker-dealer and as an Alternative Trading System dealer, respectively, which prohibit repayment of borrowings from the Company or affiliates, paying cash dividends, making loans to the Company or affiliates or otherwise entering into transactions that result in a significant reduction in regulatory net capital or financial resources, respectively, without prior notification to or approval from such regulated entity's principal regulator.

**4. Securities**

The following is a summary of the Company's Securities available-for-sale:

	<b>Amortized cost</b>	<b>Gross unrealized gains</b>	<b>Gross unrealized losses</b>	<b>Estimated fair value</b>
	<b>(In thousands)</b>			
<b>As of March 31, 2007</b>				
Federal agency issues and municipal securities	\$ 44,470	\$ 2	\$ (34)	\$ 44,438
Total Securities-available -for-sale	\$ 44,470	\$ 2	\$ (34)	\$ 44,438
<b>As of December 31, 2006</b>				
Federal agency issues and municipal securities	\$ 48,036	\$ 5	\$ (37)	\$ 48,004
Corporate Bonds	1,010	1		1,011
Total Securities-available-for-sale	\$ 49,046	\$ 6	\$ (37)	\$ 49,015

**5. Furniture, Equipment and Leasehold Improvements**

Furniture, equipment and leasehold improvements, net, are comprised of the following:

	<b>March 31, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Computer hardware and related software	\$ 15,555	\$ 15,208
Office hardware	3,171	3,166
Furniture and fixtures	1,743	1,741

Accumulated depreciation	(17,191)	(16,488)
Total furniture and equipment, net	3,278	3,627
Leasehold improvements	2,223	2,221
Accumulated amortization	(1,605)	(1,544)
Total leasehold improvements, net	618	677
Total furniture, equipment and leasehold improvements, net	\$ 3,896	\$ 4,304

**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)****6. Software Development Costs**

Software development costs, net, are comprised of the following:

	<b>March 31, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Software development costs	\$ 14,878	\$ 13,977
Accumulated amortization	(8,521)	(7,367)
Total software development costs, net	\$ 6,357	\$ 6,610

During the three months ended March 31, 2007 and 2006, software development costs totaling \$0.9 million and \$1.4 million, respectively, were capitalized. Non-capitalized software costs and routine maintenance costs are expensed as incurred and are included in Employee compensation and benefits and Professional and consulting fees in the Consolidated Statements of Operations.

**7. Income Taxes**

The provision for income taxes consists of the following:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
Current:		
Federal	\$	\$ 13
State and local		6
Foreign	(9)	(26)
Total current provision	(9)	(7)
Deferred:		
Federal	1,222	113
State and local	607	71
Foreign	199	136
Total deferred provision	2,028	320
Provision for income taxes	\$ 2,019	\$ 313

The following is a summary of the Company's net deferred tax assets:

	<b>March 31, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	

Deferred tax assets and liabilities	\$ 40,986	\$	53,669
Valuation allowance	(660)		(14,768)
Deferred tax assets, net	\$ 40,326	\$	38,901

The Company or one of its subsidiaries files U.S. federal, state and foreign income tax returns. With the exception of New York state, all U.S. federal, state and U.K. income tax returns have not been subject to audit. The Company's New York state franchise and city tax returns for 2000 through 2003 are currently under examination. While the Company cannot estimate when the examination will conclude, no material adjustments have been proposed or are expected.

As a result of the implementation of FIN 48 effective January 1, 2007, the Company recognized an increase in deferred tax assets of \$3.0 million related to previously unrecognized tax benefits, which was accounted for as an increase to Additional paid-in capital of \$0.3 million and an increase in accrued expenses of \$2.7 million. Unrecognized tax benefits as of January 1, 2007 and March 31, 2007 were \$2.7 million. If recognized, this entire amount would impact the effective tax rate. In accordance with FIN 48, certain deferred tax assets aggregating \$14.1 million were no longer recognized and the related valuation allowance was reversed.

**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)**

The Company recognizes interest accrued related to unrecognized tax benefits and penalties in General and Administrative expenses. As of the adoption date of FIN 48, accrued interest and penalties associated with any unrecognized tax benefits were zero. Nor was any interest expense recognized for the three months ended March 31, 2007.

In the first quarter of 2007, MarketAxess Holdings Inc. experienced an ownership change within the meaning of Section 382 of the Internal Revenue Code. The Company does not believe that this ownership change significantly impacts the ability to utilize existing net operating loss carryforwards

**8. Related Parties**

The Company generates commissions, information and user access fees and other income and related accounts receivable balances from Stockholder Broker-Dealer Clients or their affiliates. In addition, three Stockholder Broker-Dealer Clients act in an investment advisory, custodial and cash management capacity for the Company. The Company incurs investment advisory and bank fees in connection with these arrangements. As of the dates and for the periods indicated below, the Company had the following balances and transactions with the Stockholder Broker-Dealer Clients or their affiliates:

	As of	
	March 31, 2007	December 31, 2006
	(In thousands)	
Cash and cash equivalents	\$ 30,367	\$ 33,050
Accounts receivable	6,688	8,579
Accounts payable, accrued expenses and other liabilities	59	110
	Three Months Ended March 31,	
	2007	2006
	(In thousands)	
Commissions	\$ 8,578	\$ 8,819
Information and user access fees	186	270
Investment income	528	214
Other income	102	134
General and administrative	13	15

**9. Stockholders Equity**

As of March 31, 2007 and December 31, 2006, the Company had 110,000,000 authorized shares of common stock and 10,000,000 authorized shares of non-voting common stock. Common stock entitles the holder to one vote per share of common stock held.

During the three months ended March 31, 2007, one Stockholder Broker-Dealer Client converted 180,808 warrants into 180,770 shares of common stock through a non-cash exercise. The exercise of warrants in the current period and prior years resulted in an unrecognized deferred tax asset of \$7.8 million which will be recorded as an increase to Additional paid-in capital once the tax benefit serves to reduce taxes payable in future years.

In October 2006, the Board of Directors of the Company authorized a share repurchase program for up to \$40.0 million of the Company's common stock. The Company intends to repurchase the shares in the open market or through privately negotiated transactions, at times and prices considered appropriate by the Company. Shares repurchased under the program will be held in treasury for future use. During the three months ended March 31, 2007, a total of 1,402,157 shares were repurchased at a cost of \$18.5 million. A total of 1,592,657 shares have been repurchased at an aggregate cost of \$21.2 million from the inception of the repurchase program through March 31, 2007.





**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)****10. Stock Based Compensation Plans**

Stock based compensation expense for the three months ended March 31, 2007 and 2006 was as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
Employee:		
Stock options	\$ 913	\$ 938
Restricted stock	563	838
	1,476	1,776
Non-employee directors and consultants:		
Stock options	39	131
Restricted stock	81	53
	120	184
Total stock based compensation	\$ 1,596	\$ 1,960

The Company records stock compensation for employees in Employee compensation and benefits and for non-employee directors and consultants in General and administrative expenses in the Consolidated Statements of Operations.

In the first quarter of 2007, the Company granted to employees a total of 568,500 options to purchase shares of the Company's common stock and 12,000 shares of restricted stock. Based on the Black-Scholes-Merton closed-form model, the weighted average fair value for each option granted was \$5.94 per share. The fair value of the restricted stock granted was based on a weighted average grant date fair value of \$12.96 per share. The total pre-forfeiture compensation expense for such awards measured on the date of grant amounted to \$3.5 million and will be recognized over a three-year requisite service period.

**11. Earnings Per Share**

A reconciliation of basic to diluted weighted average shares of common stock is as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
Common stock - voting	27,688,099	25,412,966
Common stock - non-voting	3,125,379	4,401,330
Basic weighted average shares outstanding	30,813,478	29,814,296
Effect of dilutive shares:		
Warrants	2,318,930	3,674,401
Stock options and restricted stock	1,394,140	2,184,283
Diluted weighted average shares outstanding	34,526,548	35,672,980

Stock options totaling 1,078,851 and 1,648,274 for the three months ended March 31, 2007 and 2006, respectively, were excluded from the computation of diluted earnings per share because their effect would have been antidilutive.

**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)****12. Commitments and Contingencies**

The Company leases office space and equipment under non-cancelable lease agreements expiring at various dates through 2015. These leases are subject to escalation based on certain costs incurred by the landlord. Minimum rental commitments under such leases, net of sublease income, are as follows:

	<b>Minimum Rentals (In thousands)</b>
Remainder of 2007	\$ 1,879
2008	2,513
2009	2,521
2010	1,379
2011	990
2012 and thereafter	3,595

Rental expense for the three months ended March 31, 2007 and 2006 was \$0.7 million and \$0.6 million, respectively, which is included in Occupancy expenses in the Consolidated Statements of Operations. Rental expense has been recorded based on the total minimum lease payments after giving effect to rent abatement and concessions, which are being amortized on a straight-line basis over the life of the lease, and sublease income.

The Company has entered into a sublease agreement on one of its leased properties through the April 2011 lease termination date. Monthly sublease income is \$0.1 million. A loss on the sublease was recorded in 2001. The sublease loss accrual at March 31, 2007 and December 31, 2006 was \$0.8 million and \$0.9 million, respectively.

The Company is contingently obligated for standby letters of credit that were issued to landlords for office space. The Company uses a U.S. government obligation as collateral for these standby letters of credit. This collateral is included with Securities and cash provided as collateral on the Consolidated Statements of Financial Condition and had a fair market value as of March 31, 2007 and December 31, 2006 of \$3.3 million.

In June 2006, MarketAxess Corporation commenced operating an anonymous matching service for its broker-dealer clients. MarketAxess Corporation executes trades on a riskless principal basis, which are cleared and settled by an independent clearing broker. The securities clearing agreement that MarketAxess Corporation maintains with the independent clearing broker commenced in December 2004. Under the securities clearing agreement, MarketAxess Corporation maintains a collateral deposit with the clearing broker in the form of cash or U.S. government securities. As of March 31, 2007 and December 31, 2006, the collateral deposit included in Securities and cash provided as collateral on the Consolidated Statements of Financial Condition was \$0.5 million. MarketAxess Corporation is exposed to credit risk in the event a contra-party does not fulfill its obligation to complete a transaction. Pursuant to the terms of the securities clearing agreement between MarketAxess Corporation and the independent clearing broker, the clearing broker has the right to charge MarketAxess Corporation for losses resulting from a counterparty's failure to fulfill its contractual obligations. The losses are not capped at a maximum amount and apply to all trades executed through the clearing broker. At March 31, 2007, MarketAxess Corporation recorded no contingent liabilities with regard to this right.

In the normal course of business, the Company enters into contracts that contain a variety of representations, warranties and general indemnifications. The Company's maximum exposure under these arrangements is unknown, as this would involve future claims that may be made against the Company that have not yet occurred. However, based on experience, the Company expects the risk of loss to be remote.

In January 2007, two former employees of the Company commenced arbitration proceedings before the NASD against the Company arising out of the expiration of certain vested and unvested stock options and unvested restricted shares issued to them. The claims made by these two former employees total \$4.5 million plus interest.

One of the former employees has alleged that the Company wrongfully prevented him from exercising his vested options when he sought to do so and that the Company wrongfully claimed that such options had expired on the

previous day.

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**MARKETAXESS HOLDINGS INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)**

The other former employee has alleged that the Company wrongfully failed to accelerate the vesting of his then unvested options and restricted shares upon his termination and to waive the 90-day time period within which he was required to exercise his vested options. This former employee also alleges that he is entitled to a declaration that certain provisions in the Company's 2004 Stock Incentive Plan are invalid and unenforceable under applicable law. He further alleges that he is entitled to a bonus for the approximately five months that he worked for the Company during 2006.

The Company believes that both cases are without merit and intends to vigorously defend them. The Company answered both arbitration claims during March 2007. Based on currently available information, management believes that the likelihood of a material loss is not probable. Accordingly, no amounts have been provided in the accompanying financial statements. However, arbitration is subject to inherent uncertainties and unfavorable rulings could occur.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Forward-Looking Statements**

*This report contains certain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by words such as expects, intends, anticipates, plans, believes, seeks, estimates, will, or words of similar meaning and include, but are not limited to, statements regarding the outlook for our future business and financial performance. Forward-looking statements are based on management's current expectations and assumptions, which are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict. It is routine for our internal projections and expectations to change as the year or each quarter in the year progresses, and therefore it should be clearly understood that the internal projections and beliefs upon which we base our expectations may change prior to the end of each quarter or the year. Although these expectations may change, we are under no obligation to revise or update any forward-looking statements contained in this report. Our company policy is generally to provide our expectations only once per quarter, and not to update that information until the next quarter. Actual future events or results may differ materially from those contained in the projections or forward-looking statements. Factors that could cause or contribute to such differences include those discussed below and elsewhere in this report, particularly in the section captioned Part II, Item 1A, Risk Factors.*

**Executive Overview**

MarketAxess operates one of the leading platforms for the electronic trading of corporate bonds and certain other types of fixed-income securities. Through our platform, more than 680 active institutional investor client firms (firms that executed at least one trade through our electronic trading platform between April 2006 and March 2007) can access the aggregate liquidity provided by the collective interest of our 26 broker-dealer clients in buying or selling bonds through our platform. Our active institutional investor clients include investment advisers, mutual funds, insurance companies, public and private pension funds, bank portfolios and hedge funds. We also provide data and analytical tools that help our clients make trading decisions and we facilitate the trading process by electronically communicating order information between trading counterparties. Our revenues are primarily generated from the trading of U.S. and European high-grade corporate bonds.

Our multi-dealer trading platform allows our institutional investor clients to simultaneously request competing, executable bids or offers from our broker-dealer clients and execute trades with the broker-dealer of their choice from among those that choose to respond. We offer our broker-dealer clients a solution that enables them to efficiently reach our institutional investor clients for the distribution and trading of bonds. In addition to U.S. high-grade corporate bonds, European high-grade corporate bonds and emerging markets bonds, including both investment-grade and non-investment grade debt, we also offer our clients the ability to trade crossover and high-yield bonds, agency bonds and credit default swaps. Our DealerAxess® trading service allows dealers to trade fixed-income securities with each other on our platform.

The majority of our revenues are derived from commissions for trades executed on our platform that are billed to our broker-dealer clients on a monthly basis. We also derive revenues from information and user access fees, license fees, investment income and other income. Our expenses consist of employee compensation and benefits, depreciation and amortization, technology and communication expenses, professional and consulting fees, occupancy, marketing and advertising and other general and administrative expenses.

We seek to grow and diversify our revenues by capitalizing on our status as the operator of a leading platform for the electronic trading of corporate bonds and certain other types of fixed-income securities. The key elements of our strategy are:

- to innovate and efficiently add new functionality and product offerings to the MarketAxess platform that we believe will help to increase our market share with existing clients, as well as expand our client base;

- to leverage our technology, as well as our strong broker-dealer and institutional investor relationships, to deploy our electronic trading platform into additional product segments within the fixed-income securities markets;

to leverage our technology and client relationships to deploy our electronic trading platform into new client segments;

to continue building our existing service offerings so that our electronic trading platform is fully integrated into the workflow of our broker-dealer and institutional investor clients and to continue to add functionality to allow our clients to achieve a fully automated end-to-end straight-through processing solution (automation from trade initiation to settlement);



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to add new content and analytical capabilities to Corporate BondTicker™ in order to improve the value of the information we provide to our clients; and

to continue to supplement our internal growth by entering into strategic alliances, or acquiring businesses or technologies that will enable us to enter new markets, provide new products or services, or otherwise enhance the value of our platform to our clients.

**Critical Factors Affecting Our Industry and Our Company**

***Economic, Political and Market Factors***

The global fixed-income securities industry is risky and volatile and is directly affected by a number of economic, political and market factors that may result in declining trading volume. These factors could have a material adverse effect on our business, financial condition and results of operations. Any one or more of these factors may contribute to reduced trading activity in the fixed-income securities markets generally. Our revenues and profitability are likely to decline during periods of stagnant economic conditions or low trading volume in the U.S. and global fixed-income securities markets.

***Competitive Landscape***

The global fixed-income securities industry generally, and the electronic financial services markets in which we operate in particular, are highly competitive, and we expect competition to intensify in the future. We will continue to compete with bond trading conducted directly between broker-dealers and their institutional investor clients over the telephone or electronically. In addition, our current and prospective competitors are numerous and include: other multi-dealer trading companies; market data and information vendors; securities and futures exchanges; inter-dealer brokerage firms; and electronic communications networks not currently in the securities business. We believe that we compete favorably with respect to: the liquidity provided on our platform; the magnitude and frequency of price improvement enabled by our platform; the quality and speed of execution; total transaction costs; technology capabilities, including the ease of use of our trading platform; and the range of products and services.

***Regulatory Environment***

Our industry has been and is subject to continuous regulatory changes and may become subject to new regulations or changes in the interpretation or enforcement of existing regulations, which could have a material adverse effect on our business, financial condition and results of operations.

***Rapid Technological Changes***

We must continue to enhance and improve our electronic trading platform. The electronic financial services industry is characterized by increasingly complex systems and infrastructures and new business models. If new industry standards and practices emerge, our existing technology, systems and electronic trading platform may become obsolete or our existing business may be harmed. Our future success will depend on our ability to: enhance our existing products and services; develop and/or license new products and technologies that address the increasingly sophisticated and varied needs of our broker-dealer and institutional investor clients and prospective clients; and respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

**Trends in Our Business**

The majority of our revenues are derived from commissions for transactions executed on our platform between our institutional investor and broker-dealer clients. We believe that there are five key variables that impact the notional value of such transactions on our platform and the amount of commissions earned by us:

the number of institutional investor clients that participate on the platform and their willingness to originate transactions through the platform;

the number of broker-dealer clients on the platform and the competitiveness of the prices they provide to the institutional investor clients;

the number of markets for which we make trading available to our clients;

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the overall level of activity in these markets; and

the level of commissions that we collect for trades executed through the platform.

We believe that overall corporate bond market trading volume is affected by various factors including the absolute levels of interest rates, the direction of interest rate movements, the level of new issues of corporate bonds and the volatility of corporate bond spreads versus U.S. Treasury securities. Because a significant percentage of our revenue is tied directly to the volume of securities traded on our platform, it is likely that a general decline in trading volumes, regardless of the cause of such decline, would reduce our revenues and have a significant negative impact on profitability.

We have historically earned a substantial portion of our commissions and overall revenues from broker-dealer clients that are (or whose affiliates are) our stockholders. For 2006, a total of nine dealers were considered to be Stockholder Broker-Dealer Clients. The number of Stockholder Broker-Dealer Clients has been reduced from nine for the three months ended March 31, 2006 to seven for the three months ended March 31, 2007. The percentage of our revenues derived from our Stockholder Broker-Dealer Clients has been declining. For the three months ended March 31, 2007, the percentage decreased to 39.5% from 46.4% for the three months ended March 31, 2006. Affiliates of most of our Stockholder Broker-Dealer Clients are also among our institutional investor clients. A table detailing the amount of revenues generated by the seven Stockholder Broker-Dealer Clients as of January 1, 2007 (Banc of America Securities, Bear Stearns, BNP Paribas, Credit Suisse, JPMorgan, Lehman Brothers and UBS), and their respective affiliates, as well as the corresponding percentage of total revenues, is provided below for the three months ended March 31, 2007 and 2006.

	Three Months Ended March 31, 2007		2006	
	\$	% of Revenues (\$ in thousands)	\$	% of Revenues
Commissions	\$ 8,578	36.1%	\$ 8,819	43.4%
Information and user access fees	186	0.8	270	1.3
Investment income	528	2.2	214	1.1
Other	102	0.4	134	0.7
	\$ 9,394	39.5%	\$ 9,437	46.4%

**Commission Revenue Trends**

Commissions are generally calculated as a percentage of the notional dollar volume of bonds traded on our platform and vary based on the type, size, yield and maturity of the bond traded. The commission rates are based on a number of factors, including fees charged by inter-dealer brokers in the respective markets, average bid-offer spreads in the products we offer, transaction costs through alternative channels including the telephone and the trading volume executed through our platform by the broker-dealer completing the trade. Under our transaction fee plans, bonds that are more actively traded or that have shorter maturities are generally charged lower commissions, while bonds that are less actively traded or that have longer maturities generally command higher commissions.

*U.S. High-Grade Corporate Bond Commissions* On June 1, 2005, we introduced a new fee plan primarily for secondary market transactions in U.S. high-grade corporate bonds executed on our institutional client to multi-dealer electronic trading platform. Most of our U.S. high-grade broker-dealer clients signed new two-year agreements in 2005. The agreements incorporate higher fixed monthly fees and lower variable fees for our broker-dealer clients than the previous U.S. high-grade corporate transaction fee plans and incorporate volume incentives to our broker-dealer clients that are designed to increase the volume of transactions effected on our platform. Under the fee plan, we electronically add the variable fee to the spread quoted by the broker-dealer client but do not charge for inquiries that an institutional investor client sends to a single broker-dealer client. The combination of higher fixed and lower

variable fees in the plan results in higher revenue to us at lower volume levels but will limit revenue growth in the future for U.S. high-grade corporate bond trading as volume levels increase. For trades on our DealerAxess® dealer-to-dealer electronic trading platform, we charge a fee to the broker-dealer client involved in the transaction that is based on the size of the transaction and the maturity of the bond traded. Monthly minimum fees apply to certain dealers participating on the DealerAxess® platform in their first year of trading. The majority of the monthly minimum commitments expire as of June 30, 2007.

*European High-Grade Corporate Bond Commissions* For European high-grade corporate bond trades, broker-dealer transaction fees vary based on the type of bond traded. Different fee schedules apply to fixed rate and floating rate bonds. Within the schedule for fixed rate bonds, the fee varies depending on whether the bond is a corporate or a sovereign issue. For corporate bonds, the fee also

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varies depending on the maturity of the issue. This fee schedule applies a tiered fee structure, which reduces the fee per trade upon the attainment of certain specified amounts of monthly commissions generated by a particular broker-dealer and does not carry a fixed monthly fee or fee cap.

*Other Commissions* Commissions for other bond trades generally vary based on the type and the maturity of the bond traded. Factors that we consider when setting commission rates include those charged by inter-dealer brokers in the respective markets, average bid-offer spreads in the products we serve and transaction costs through alternative channels including the telephone. For credit default swap index trades we charge commissions to both broker-dealer and institutional investor clients calculated as a percentage of the notional volume of transactions traded.

We anticipate that some reduction in average fees per million may occur in the future. Consequently, past trends in commissions are not necessarily indicative of future commissions.

***Other Revenue Trends***

In addition to the commissions discussed above, we earn revenue from information services fees paid by institutional investor and broker-dealer clients, from license fees and from income on investments.

*Information and User Access Fees* We charge information services fees for Corporate BondTicker to our broker-dealer clients, institutional investor clients and data-only subscribers. The information services fee is a flat monthly fee, based on the level of service. We also generate information services fees from the sale of bulk data to certain institutional investor clients and data-only subscribers. Institutional investor clients trading U.S. high-grade corporate bonds are charged a monthly user access fee for the use of our platform. The fee, billed quarterly, is charged to the client based on the number of the client's users. To encourage institutional investor clients to execute trades on our U.S. high-grade corporate bond platform, we reduce these information and user access fees for such clients once minimum quarterly trading volumes are attained.

*License Fees* License fees consist of fees received from broker-dealer clients for access to our trading platform through a non-exclusive and non-transferable license. Broker-dealer clients, other than those that made equity investments in the Company, typically pay an initial license fee, which is due and payable upon execution of the broker-dealer agreement. The initial license fee varies by agreement and at a minimum is generally intended to cover the initial set-up costs incurred to enable a broker-dealer to begin using our electronic trading platform. The license fee is recognized in the first three months of the agreement in the estimated amount of the set-up costs that we incur and the remaining amount is amortized over the initial term of the agreement, which is generally three years. We anticipate that license fees will be a less material source of revenues for us on a going-forward basis.

*Investment Income* Investment income consists of income earned on our investments. In November 2006, we commenced a \$40.0 million share repurchase program. Investment income will decline as we use our cash to purchase our common stock under the share repurchase program.

*Other* Other revenues consist of telecommunications line charges to broker-dealer clients and other miscellaneous revenues.

***Expense Trends***

In the normal course of business, we incur the following expenses:

*Employee Compensation and Benefits* Employee compensation and benefits is our most significant expense and includes employee salaries, stock compensation costs, other incentive compensation, employee benefits and payroll taxes. Effective January 1, 2006, we adopted SFAS 123R, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees based on estimated fair values.

*Depreciation and Amortization* Depreciation and amortization expense results from the depreciation of fixed assets, which consist of computer hardware, furniture and fixtures, and the amortization of software, capitalized software development costs and leasehold improvements. We depreciate our fixed assets and amortize our capitalized software development costs on a straight-line basis over a three-year period. We amortize leasehold improvements on a straight-line basis over the lesser of the life of the improvement or the remaining term of the lease.

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*Technology and Communications* Technology and communications expense consists primarily of costs relating to maintenance on software and hardware, our internal network connections, data center hosting costs and data feeds provided by outside vendors or service providers. The majority of our broker-dealer clients have dedicated high-speed communication lines to our network in order to provide fast data transfer. We charge our broker-dealer clients a monthly fee for these connections, which is recovered against the relevant expenses we incur.

*Professional and Consulting Fees* Professional and consulting fees consist primarily of accounting fees, legal fees and fees paid to information technology and non-information technology consultants for services provided for the maintenance of our trading platform and information services products.

*Occupancy* Occupancy costs consist primarily of office and equipment rent, utilities and commercial rent tax.

*Marketing and Advertising* Marketing and advertising expense consists primarily of print and other advertising expenses we incur to promote our products and services. This expense also includes costs associated with attending or exhibiting at industry-sponsored seminars, conferences and conventions, and travel and entertainment expenses incurred by our sales force to promote our trading platform and information services.

*General and Administrative* General and administrative expense consists primarily of general travel and entertainment, board of directors expenses, charitable contributions, provision for doubtful accounts, and various state franchise and U.K. value-added taxes.

We anticipate expense growth in the future, primarily due to investment in new products, notably in employee compensation and benefits, professional and consulting fees, and general and administrative expense, but we believe that operating leverage can be achieved by increasing volumes in existing products and adding new products without substantial additions to our infrastructure.

**Critical Accounting Policies**

This Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States, also referred to as U.S. GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of income and expenses during the reporting periods. We base our estimates and judgments on historical experience and on various other factors that we believe are reasonable under the circumstances. Actual results may differ from these estimates under varying assumptions or conditions. Note 2 of the Notes to our Consolidated Financial Statements includes a summary of the significant accounting policies and methods used in the preparation of our Consolidated Financial Statements.

In June 2006, the FASB issued FIN 48 which applies to all tax positions accounted for under SFAS 109. A tax position includes current or future reductions in taxable income reported or expected to be reported on a tax return. FIN 48 supplements SFAS 109 by defining the confidence level that a tax position must meet in order to be recognized in the financial statements. The interpretation requires that the tax effects of a position be recognized only if it is more-likely-than-not (greater than 50% likelihood) to be sustained based solely on its technical merits as of the reporting date. In making this assessment, a company must assume that the taxing authorities will examine the position. As a result of the implementation of FIN 48 effective January 1, 2007, the Company recognized an increase in deferred tax assets of \$3.0 million related to previously unrecognized tax benefits, which was accounted for as an increase to Additional paid-in capital of \$0.3 million and an increase in accrued expenses of \$2.7 million.

Other than the adoption of FIN 48 effective January 1, 2007, there were no significant changes to our critical accounting policies and estimates during the three months ended March 31, 2007, as compared to those we disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2006.

**Segment Results**

As an electronic, multi-dealer to client platform for trading fixed-income securities, our operations constitute a single business segment pursuant to SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information. Because of the highly integrated nature of the financial markets in which we compete and the integration of our worldwide business activities, we believe that results by geographic region, products or types of clients are not necessarily meaningful in understanding our business.



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Our trading volume for each of the periods presented was as follows:

	<b>Three Months Ended March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>Trading Volume Data (in billions)</b>		
U.S. high-grade multi dealer	\$ 55.9	\$ 40.6
U.S. high-grade single dealer	4.9	5.3
Total U.S. high-grade	60.8	45.9
European high-grade	28.3	24.0
Other	15.3	14.6
Total	\$ 104.4	\$ 84.5
Number of U.S. Trading Days	62	62
Number of U.K. Trading Days	64	64

For volume reporting purposes, transactions in foreign currencies are converted to U.S. dollars at the exchange rate prevailing on the day the transactions were executed. Single-dealer inquiries represent U.S. high-grade trades on which no fees were charged in accordance with the U.S. high-grade corporate bond fee plan that went into effect on June 1, 2005. Credit default swap trading volume data are included in Other. Trading volume data related to DealerAxess® bond trading between broker-dealer clients are included in either U.S. high-grade or Other trading volumes, as appropriate.

Our active institutional investor clients (firms that executed at least one trade through our electronic trading platform for the twelve months ended March 31, 2007 and 2006, respectively) and our broker-dealer clients as of March 31, 2007 and 2006 were as follows:

	<b>March 31,</b>	
	<b>2007</b>	<b>2006</b>
<b>Institutional Investor Clients:</b>		
U.S.	465	441
Europe	224	234
Total	689	675
Broker-Dealer Clients	26	25

**Results of Operations*****Three Months Ended March 31, 2007 Compared to Three Months Ended March 31, 2006******Overview***

Total revenues increased by \$3.4 million or 16.8% to \$23.8 million for the three months ended March 31, 2007 from \$20.3 million for the three months ended March 31, 2006. This increase in total revenues was primarily due to increases in total commissions of \$3.2 million and investment income of \$0.3 million.

Total expenses increased by \$0.4 million or 1.9% to \$19.3 million for the three months ended March 31, 2007 from \$18.9 million for the three months ended March 31, 2006. This increase was primarily due to an increase of \$1.2 million in employee compensation and benefits offset by declines in professional and consulting fees of

\$0.7 million and technology and communications expenses of \$0.3 million.

For the three months ended March 31, 2007, income before taxes increased by \$3.1 million or 219.4% to \$4.5 million compared to \$1.4 million for the three months ended March 31, 2006. Net income increased by \$1.4 million or 125.6% to \$2.4 million compared to \$1.1 million for three months ended March 31, 2006.



**Table of Contents***Revenues*

Our revenues and percentage of revenues for the three months ended March 31, 2007 and 2006, and the resulting dollar and percentage changes, were as follows:

	Three Months Ended March 31,					
	2007		2006		\$ Change	% Change
	\$	% of Revenues	\$	% of Revenues		
	(\$ in thousands)					
<b>Revenues</b>						
Commissions						
U.S. high-grade	\$ 13,682	57.6%	\$ 11,029	54.2%	\$ 2,653	24.1%
European high-grade	4,754	20.0	4,338	21.3	416	9.6
Other	2,257	9.5	2,120	10.4	137	6.5
Total commissions	20,693	87.1	17,487	86.0	3,206	18.3
Information and user access fees	1,354	5.7	1,359	6.7	(5)	(0.4)
License fees	239	1.0	281	1.4	(42)	(14.9)
Investment income	1,222	5.1	962	4.7	260	27.0
Other	257	1.1	251	1.2	6	2.4
Total revenues	\$ 23,765	100.0%	\$ 20,340	100.0%	\$ 3,425	16.8%

*Commissions.* Total commissions increased by \$3.2 million or 18.3% to \$20.7 million for the three months ended March 31, 2007 from \$17.5 million for the three months ended March 31, 2006. The following table shows the extent to which the increase in commissions for the three months ended March 31, 2007 as compared to the three months ended March 31, 2006 was attributable to transaction volumes, fixed monthly distribution and DealerAxess® minimum fees and the average level of variable transaction fees:

	Change from Three Months Ended March 31, 2006			
	U.S. High- Grade	European High- Grade	Other	Total
	(In thousands)			
Volume increases	\$ 1,253	\$ 777	\$ 102	\$ 2,132
Fixed monthly distribution fees	488			488
DealerAxess® minimum fees	1,544			1,544
Average variable transaction fees	(632)	(361)	35	(958)
Total commissions increase	\$ 2,653	\$ 416	\$ 137	\$ 3,206

U.S. high-grade, European high-grade and Other experienced overall volume improvements of 32.5%, 17.9% and 4.8%, respectively. The increase in U.S. high-grade volume was due primarily to an increase in the Company's estimated market share of total U.S. high-grade corporate bond volume as reported by NASD Trade Reporting and Compliance Engine (TRACE) from 7.6% for the three months ended March 31, 2006 to 9.4% for the three months ended March 31, 2007 and bond trading between broker dealer clients through our DealerAxess® product launched in June 2006. Estimated NASD TRACE U.S. high-grade volume increased from \$602.3 billion for the three months ended March 31, 2006 to \$649.3 billion for the three months ended March 31, 2007. The European high-grade volume

increases were attributable to foreign currency exchange changes and an increase in the local currency volume of trading. The fixed monthly U.S. high-grade distribution fees were \$7.7 million for the three months ended March 31, 2007, compared to \$7.2 million for the three months ended March 31, 2006. The DealerAxess® monthly minimum fees were \$1.5 million for the three months ended March 31, 2007. The majority of the minimum fee commitments expire as of June 30, 2007. There were no DealerAxess® monthly minimum fees for the three months ended March 31, 2006.

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Our average fees per million for the three months ended March 31, 2007 and 2006 were as follows:

	<b>Three Months Ended March</b>	
	<b>2007</b>	<b>2006</b>
<b>Average Fee Per Million</b>		
U.S. high-grade	\$ 225	\$ 240
European high-grade	\$ 168	\$ 181
Other	\$ 148	\$ 145
All Products	\$ 198	\$ 207

The U.S. high-grade average fee per million is calculated for each period presented using both the variable transaction fees and the fixed monthly fees paid by our broker-dealer clients. The U.S. high-grade average fee per million decreased due to the structure of our fee plan, which has a combination of fixed monthly distribution fees and variable transaction fees, resulting in lower average fees per million at higher trading volumes, and the shorter maturity of trades executed on the platform. Excluding revenues and volumes associated with DealerAxess®, U.S. high-grade fees per million were \$206 for the three months ended March 31, 2007. The decrease in the European high-grade average fee per million for the three months ended March 31 2006 as compared to the three months ended March 31, 2007 resulted from higher trading volumes in floating-rate notes, which have lower fees per million.

*Information and User Access Fees.* Information and user access fees were \$1.4 million for both the three months ended March 31, 2007 and 2006.

*License Fees.* License fees decreased to \$0.2 million for the three months ended March 31, 2007 from \$0.3 million for the three months ended March 31, 2006. The decrease was due to a decline in the amortization of deferred license fee, partially offset by the recognition of a portion of the initial license fee from one new dealer that went live on the platform in March 2007. We anticipate that license fees will be a less material source of revenues for us on a going-forward basis.

*Investment Income.* Investment income increased to \$1.2 million for the three months ended March 31, 2007 from \$1.0 million for the three months ended March 31, 2006. This increase was primarily due to higher Cash and cash equivalents and Securities available-for-sale balances and a rise in interest rates during the three months ended March 31, 2007 as compared to the three months ended March 31, 2006.

*Other.* Other revenues were \$0.3 million for both the three months ended March 31, 2007 and 2006.

**Expenses**

Our expenses and percentage of revenues for the three months ended March 31, 2007 and 2006, and the resulting dollar and percentage changes, were as follows:

	<b>Three Months Ended March 31,</b>			
	<b>2007</b>		<b>2006</b>	
	\$	% of	\$	%
		<b>Revenues</b>		<b>Revenues</b>