

MARKETAXESS HOLDINGS INC

Form 10-Q

November 02, 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 September 30, 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

As of October 30, 2007, the number of shares of the Registrant's voting common stock outstanding was 30,828,017 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 SEPTEMBER 30, 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)**

	As of	
	September 30, 2007	December 31, 2006
	(In thousands, except share and per share amounts)	
<b>ASSETS</b>		
Cash and cash equivalents	\$ 74,350	\$ 82,000
Securities and cash provided as collateral	3,766	3,798
Securities available-for-sale	53,449	49,015
Accounts receivable, including receivables from related parties of \$6,411 and \$8,579, respectively, net of allowance of \$827 and \$752 as of September 30, 2007 and December 31, 2006, respectively	19,682	17,429
Furniture, equipment and leasehold improvements, net of accumulated depreciation and amortization	3,251	4,304
Software development costs, net of amortization	5,991	6,610
Prepaid expenses and other assets	1,322	2,221
Deferred tax assets, net	36,558	38,901
<b>Total assets</b>	<b>\$ 198,369</b>	<b>\$ 204,278</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
<b>Liabilities</b>		
Accrued employee compensation	\$ 11,471	\$ 12,813
Deferred revenue	1,144	857
Accounts payable, accrued expenses, and other liabilities, including payables to related parties of \$118 and \$110 as of September 30, 2007 and December 31, 2006, respectively	9,423	5,323
<b>Total liabilities</b>	<b>22,038</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 with no shares issued and outstanding as of September 30, 2007 and December 31, 2006		
Common stock voting, \$0.003 par value, 110,000,000 shares authorized as of September 30, 2007 and December 31, 2006; 33,010,307 shares and 29,409,537 shares issued as of September 30, 2007 and December 31, 2006, respectively	99	88
Common stock non-voting, \$0.003 par value, 10,000,000 authorized as of September 30, 2007 and December 31, 2006; 2,585,654 shares and	9	11

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3,125,379 shares issued and outstanding as of September 30, 2007 and December 31, 2006, respectively

Warrants, 0 and 2,379,396 authorized, issued and outstanding as of September 30, 2007 and December 31, 2006, respectively

Additional paid-in capital	286,605	11,658
Receivable for common stock subscribed	(834)	265,030
Treasury stock - Common stock voting, at cost, 2,112,197 shares and 190,500 shares as of September 30, 2007 and December 31, 2006, respectively	(30,030)	(1,042)
Accumulated deficit	(78,662)	(2,653)
Accumulated other comprehensive loss	(856)	(87,074)
<b>Total stockholders equity</b>	176,331	(733)
<b>Total liabilities and stockholders equity</b>	\$ 198,369	\$ 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 Sept.</b>		<b>Nine Months Ended Sept. 30,</b>	
	<b>30,</b>		<b>2007</b>	<b>2006</b>
	<b>2007</b>	<b>2006</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 \$4,756, \$6,064, \$16,896 and \$17,034 from related parties for the three and nine months ended				
September 30, 2007 and 2006, respectively	\$ 11,982	\$ 12,250	\$ 40,196	\$ 34,254
European high-grade, including \$1,235, \$1,401, \$3,770 and \$5,095 from related parties for the three and nine months ended				
September 30, 2007 and 2006, respectively	4,889	3,290	14,099	11,717
Other, including \$1,002, \$1,285, \$3,597 and \$4,120 from related parties for the three and nine months ended September 30, 2007 and 2006, respectively				
	2,107	2,057	6,832	6,371
<b>Total commissions</b>	<b>18,978</b>	<b>17,597</b>	<b>61,127</b>	<b>52,342</b>
Information and user access fees, including \$218, \$290, \$595 and \$898 from related parties for the three and nine months ended				
September 30, 2007 and 2006, respectively	1,535	1,426	4,357	4,108
License fees				
	90	247	658	742
Investment income, including \$474, \$227, \$1,388 and \$719 from related parties for the three and nine months ended September 30, 2007 and 2006, respectively				
	1,332	1,266	3,812	3,312
Other, including \$150, \$125, \$352 and \$389 from related parties for the three and nine months ended September 30, 2007 and 2006, respectively				
	263	238	1,313	732
<b>Total revenues</b>	<b>22,198</b>	<b>20,774</b>	<b>71,267</b>	<b>61,236</b>
<b>Expenses</b>				
Employee compensation and benefits	10,258	10,483	32,771	31,264
Depreciation and amortization	1,686	1,703	5,476	5,025
Technology and communications	1,897	1,956	5,595	5,799
Professional and consulting fees	1,883	1,883	5,505	6,922
Occupancy	869	778	2,423	2,270
Marketing and advertising	481	338	1,364	1,193
General and administrative, including \$7, \$16, \$32 and \$47 to related parties for the	1,481	1,403	3,982	3,748

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three and nine months ended September 30,  
2007 and 2006, respectively

<b>Total expenses</b>	18,555	18,544	57,116	56,221
Income before income taxes	3,643	2,230	14,151	5,015
Provision for income taxes	1,233	933	5,739	1,832
<b>Net income</b>	\$ 2,410	\$ 1,297	\$ 8,412	\$ 3,183
Net income per common share				
Basic	\$ 0.07	\$ 0.04	\$ 0.26	\$ 0.11
Diluted	\$ 0.07	\$ 0.04	\$ 0.24	\$ 0.09
Weighted average shares outstanding				
Basic	32,828,978	31,319,771	32,190,478	30,274,448
Diluted	34,575,086	34,792,784	34,592,715	35,028,296

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





stock									
Exercise of warrants	7		(11,658)	11,651					
Repayment of promissory notes					208				208
Purchase of treasury stock						(27,377)			(27,377)
Balance at September 30, 2007	\$ 99	\$ 9	\$	\$ 286,605	\$ (834)	\$ (30,030)	\$ (78,662)	\$ (856)	\$ 176,331

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>Nine Months Ended September 30, 2007      2006 (In thousands)</b>	
<b>Cash flows from operating activities</b>		
Net income	\$ 8,412	\$ 3,183
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,476	5,025
Stock based compensation expense	4,101	4,541
Deferred taxes	5,350	762
Provision for bad debts	272	538
Changes in operating assets and liabilities:		
(Increase) in accounts receivable, including decrease (increase) of \$2,168 and (\$2,167) from related parties for the nine months ended September 30, 2007 and 2006, respectively	(2,525)	(4,538)
Decrease in prepaid expenses and other assets	899	1,667
(Decrease) in accrued employee compensation	(1,342)	(3,097)
Increase (decrease) in deferred revenue	287	(579)
Increase in accounts payable, accrued expenses and other liabilities, including increase of \$8 and \$157 to related parties for the nine months ended September 30, 2007 and 2006	1,400	577
<b>Net cash provided by operating activities</b>	<b>22,330</b>	<b>8,079</b>
<b>Cash flows from investing activities</b>		
Securities available-for-sale:		
Proceeds from maturities and sales	36,855	65,039
Purchases	(41,250)	(63,213)
Securities and cash provided as collateral	32	42
Purchases of furniture, equipment and leasehold improvements	(1,137)	(2,309)
Capitalization of software development costs	(2,645)	(2,824)
<b>Net cash used in investing activities</b>	<b>(8,145)</b>	<b>(3,265)</b>
<b>Cash flows from financing activities</b>		
Proceeds from the exercise of stock options and grants of restricted stock	5,112	1,516
Excess tax benefits from stock-based compensation	389	1,076
Repayment of promissory notes	208	
Purchase of treasury stock    common stock voting	(27,377)	
<b>Net cash (used in) provided by financing activities</b>	<b>(21,668)</b>	<b>2,592</b>
<b>Effect of exchange rate changes on cash</b>	<b>(167)</b>	<b>(302)</b>
<b>Cash and cash equivalents</b>		
Net (decrease) increase for the period	(7,650)	7,104

Beginning of period	82,000	58,189
<b>End of period</b>	<b>\$ 74,350</b>	<b>\$ 65,293</b>
<b>Supplemental cash flow information:</b>		
<b>Cash paid during the period:</b>		
Income taxes paid	\$ 127	\$ 203
<b>Non-cash activity:</b>		
Non-cash exercise of warrants and issuance of common stock	\$ 11,658	\$ 6,035

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, Brownstone Investment Group, Calyon, CIBC World Markets, 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, KBC Financial Products, Lehman Brothers, Merrill Lynch, Morgan Stanley, RBC Capital Markets, The Royal Bank of Scotland, Santander Investment Securities, SG Corporate & Investment Banking, UBS, Wachovia Securities and Wall Street Access.

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 with the Financial Services Authority (FSA) in the United Kingdom (U.K.) and will become a Multilateral Trading Facility following implementation of the Markets in Financial Instruments Directive in November 2007; 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*****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 in the Consolidated Statements of Financial Condition. Realized gains and losses are recorded in 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 decreases 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 the American Institute of Certified Public Accountants 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. The Company also derives revenues from information and user access fees, license fees, investment income and other income. Other income includes revenues from technology consulting services.

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 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, generally 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

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

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 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.

Revenues from contracts for technology integration consulting services are recognized on the percentage-of-completion method in accordance with Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*. Percentage-of-completion accounting involves calculating the percentage of services provided during the reporting period compared to the total estimated services to be provided over the duration of the contract. If estimates indicate that a contract loss will occur, a loss provision is recorded in the period in which the loss first becomes probable and reasonably estimable. Contract losses are determined to be the amount by which the estimated direct and indirect costs of the contract exceed the estimated total revenues that will be generated by the contract. There were no contract loss provisions recorded as of September 30, 2007. Revenues recognized in excess of billings are recorded as unbilled services. Billings in excess of revenues recognized are recorded as Deferred revenues until revenue recognition criteria are met.

***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 in the Consolidated Statements of Operations.

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.



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

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.

**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)****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>September 30, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Net capital	\$ 18,575	\$ 14,982
Required net capital	(1,031)	(1,048)
Excess net capital	\$ 17,544	\$ 13,934
Ratio of aggregate indebtedness to net capital	.83 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.

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

	<b>September 30, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Financial resources	\$ 17,716	\$ 14,882
Resource requirement	(7,707)	(4,372)
Excess financial resources	\$ 10,009	\$ 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 September 30, 2007</b>				
Federal agency issues and municipal securities	\$ 53,442	\$ 11	\$ (4)	\$ 53,449

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Total Securities available-for-sale	\$ 53,442	\$ 11	\$ (4)	\$ 53,449
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**As of December 31, 2006**

Federal agency issues and municipal securities	\$ 48,036	\$ 5	\$ (37)	\$ 48,004
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Corporate Bonds	1,010	1		1,011
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Total Securities available-for-sale	\$ 49,046	\$ 6	\$ (37)	\$ 49,015
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**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)****5. Furniture, Equipment and Leasehold Improvements**

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

	<b>September 30, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Computer hardware and related software	\$ 16,254	\$ 15,208
Office hardware	3,241	3,166
Furniture and fixtures	1,819	1,741
Leasehold improvements	2,239	2,221
Accumulated depreciation and amortization	(20,302)	(18,032)
<b>Total furniture, equipment and leasehold improvements, net</b>	<b>\$ 3,251</b>	<b>\$ 4,304</b>

**6. Software Development Costs**

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

	<b>September 30, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Software development costs	\$ 16,632	\$ 13,977
Accumulated amortization	(10,641)	(7,367)
<b>Total software development costs, net</b>	<b>\$ 5,991</b>	<b>\$ 6,610</b>

During the nine months ended September 30, 2007 and 2006, software development costs totaling \$2.6 million and \$2.8 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 September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Current:				
Federal	\$	\$ 187	\$	\$ 421
State and local		37	88	78
Foreign	(9)	142	69	347
<b>Total current provision</b>	<b>(9)</b>	<b>366</b>	<b>157</b>	<b>846</b>
Deferred:				

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Federal	550	310	3,163	436
State and local	303	366	1,560	523
Foreign	389	(109)	859	27
Total deferred provision	1,242	567	5,582	986
Provision for income taxes	\$ 1,233	\$ 933	\$ 5,739	\$ 1,832

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

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

	<b>September 30, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Deferred tax assets and liabilities	\$ 37,218	\$ 53,669
Valuation allowance	(660)	(14,768)
Deferred tax assets, net	\$ 36,558	\$ 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 and Connecticut state tax returns, all U.S. federal, state and U.K. income tax returns have not been subject to audit. The Company's New York State franchise tax returns for 2000 through 2003 and Connecticut income tax returns for 2002 through 2004 are currently under examination. An examination of the New York City tax returns for 2001 to 2003 recently concluded with no adjustments. The Company cannot estimate when the other examinations will conclude.

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 September 30, 2007 were \$2.7 million and \$2.8 million, respectively. 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.

The Company recognizes interest and penalties related to unrecognized tax benefits in General and administrative expenses in the Consolidated Statements of Operations. As of the adoption date of FIN 48, accrued interest and penalties associated with any unrecognized tax benefits were zero. Interest expense recognized for the nine months ended September 30, 2007 was \$30 thousand.

In the first quarter of 2007, the Company 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, two Stockholder Broker-Dealer Clients act in an investment advisory, custodial and cash management capacity for the Company. The Company also maintains an account with a Stockholder Broker-Dealer Client in connection with its share repurchase program. 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:

	<b>September 30, 2007</b>	<b>As of December 31, 2006</b>
	<b>(In thousands)</b>	
Cash and cash equivalents	\$57,753	\$ 33,050
Accounts receivable	6,411	8,579

Accounts payable, accrued expenses and other liabilities	118	110
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	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Commissions	\$ 6,993	\$ 8,750	\$ 24,263	\$ 26,249
Information and user access fees	218	290	595	898
Investment income	474	227	1,388	719
Other income	150	125	352	389
General and administrative	7	16	32	47
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**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)****9. Stockholders Equity**

As of September 30, 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. Voting common stock entitles the holder to one vote per share of common stock held. During the nine months ended September 30, 2007, a total of 539,725 shares of non-voting common stock were converted to voting common stock.

During the nine months ended September 30, 2007, two Stockholder Broker-Dealer Clients converted 2,379,200 warrants into 2,378,764 shares of common stock through non-cash exercises. The exercise of warrants in the current period and prior years resulted in an unrecognized deferred tax asset of \$19.2 million that 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 has repurchased and may continue 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 September 30, 2007, a total of 204,840 shares were repurchased at a cost of \$3.5 million. During the nine months ended September 30, 2007, a total of 1,921,697 shares were repurchased at a cost of \$27.4 million. A total of 2,112,197 shares have been repurchased at an aggregate cost of \$30.0 million from the inception of the repurchase program through September 30, 2007.

**10. Stock-Based Compensation Plans**

Stock-based compensation expense for the three and nine months ended September 30, 2007 and 2006 was as follows:

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Employee:				
Stock options	\$ 583	\$ 677	\$ 2,264	\$ 2,529
Restricted stock	568	484	1,518	1,617
	1,151	1,161	3,782	4,146
Non-employee directors and consultants:				
Stock options	36	39	101	226
Restricted stock	83	81	218	169
	119	120	319	395
Total stock-based compensation	\$ 1,270	\$ 1,281	\$ 4,101	\$ 4,541

The Company records stock-based 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.

During the nine months ended September 30, 2007, the Company granted to employees and directors a total of 596,500 options to purchase shares of the Company's common stock and 32,000 shares of restricted stock. Based on



the Black-Scholes-Merton closed-form model, the weighted average fair value for each option granted was \$6.01 per share. The fair value of the restricted stock granted was based on a weighted average grant date fair value of \$15.48 per share. The total pre-forfeiture compensation expense for such awards measured on the date of grant amounted to \$4.1 million and will be recognized over the requisite service period, which is typically three years.

**Table of Contents****MARKETAXESS HOLDINGS INC.****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS Unaudited (Continued)****11. Earnings Per Share**

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

	<b>Three Months Ended September</b>		<b>Nine Months Ended September</b>	
	<b>30,</b>	<b>30,</b>	<b>30,</b>	<b>30,</b>
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Common stock voting	30,243,324	27,910,847	29,424,916	26,251,178
Common stock non-voting	2,585,654	3,408,924	2,765,562	4,023,270
Basic weighted average shares outstanding	32,828,978	31,319,771	32,190,478	30,274,448
Effect of dilutive shares:				
Warrants		2,379,199	772,977	3,242,667
Stock options and restricted stock	1,746,108	1,093,814	1,629,260	1,511,181
Diluted weighted average shares outstanding	34,575,086	34,792,784	34,592,715	35,028,296

Stock options and restricted stock totaling 457,043 and 4,051,000 shares for the three months ended September 30, 2007 and 2006, respectively, and 664,911 and 2,802,730 shares for the nine months ended September 30, 2007 and 2006, respectively, were excluded from the computation of diluted earnings per share because their effect would have been antidilutive.

**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	\$ 636
2008	2,550
2009	2,558
2010	1,417
2011	1,028
2012 and thereafter	3,738

Rental expense of \$0.8 million and \$0.7 million for the three months ended September 30, 2007 and 2006, respectively, and \$2.1 million for each of the nine months ended September 30, 2007 and 2006 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 as of September 30, 2007 and December 31, 2006 was \$0.7 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 of \$3.3 million as of September 30, 2007 and December 31, 2006.

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

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

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 September 30, 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 counterparty 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. As of September 30, 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.

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.

**13. Comprehensive Income**

Comprehensive income was as follows:

	<b>Three Months</b>		<b>Nine Months Ended September</b>	
	<b>Ended September</b>		<b>30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>			
Net income	\$ 2,410	\$ 1,297	\$ 8,412	\$ 3,183
Cumulative translation adjustment and foreign currency exchange hedge, net of taxes	(62)	(152)	(145)	(302)
Unrealized net gains on Securities available-for-sale, net of taxes	53	85	22	78
Total Comprehensive income	\$ 2,401	\$ 1,230	\$ 8,289	\$ 2,959



**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, 691 active institutional investor client firms (firms that executed at least one trade through our electronic trading platform between October 2006 and September 2007) can access the aggregate liquidity provided by the collective interest of our 30 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. We offer our 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. Our DealerAxess<sup>®</sup> 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; deliver fixed income securities-related technical services and products; and 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);

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

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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;

the overall level of activity in these markets; and

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





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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.

The third quarter of 2007 was a period of significant turmoil in the U.S. and European credit markets. A widespread retrenchment in the credit markets resulted in increased credit spreads and significantly higher credit spread volatility across a wide range of asset classes. We believe the resultant lack of liquidity in the credit markets led institutional investors to conduct a higher percentage of their trades directly with their broker-dealer counterparties resulting in lower volumes on our platform and that a normalization in credit market conditions is likely to favorably impact the volume of trades conducted over our platform.

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, and for 2007, a total of seven dealers, were considered to be Stockholder Broker-Dealer Clients. The percentage of our revenues derived from our Stockholder Broker-Dealer Clients has been declining. For the nine months ended September 30, 2007, the percentage decreased to 37.3% from 46.1% for the nine months ended September 30, 2006. Affiliates of most of our Stockholder Broker-Dealer Clients are also among our institutional investor clients. A table detailing the amount of our revenues generated by the Stockholder Broker-Dealer Clients, and their respective affiliates, as well as the corresponding percentage of our total revenues, is provided below for the three and nine months ended September 30, 2007 and 2006.

	<b>Three Months Ended Sept. 30,</b>		<b>Nine Months Ended Sept. 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
	(\$ in thousands)			
Commissions	\$ 6,993	\$ 8,750	\$ 24,263	\$ 26,249
Information and user access fees	218	290	595	898
Investment income	474	227	1,388	719
Other	150	125	352	389
	\$ 7,835	\$ 9,392	\$ 26,598	\$ 28,255
Percentage of total revenues	35.3%	45.2%	37.3%	46.1%

**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 and transaction costs through alternative channels including the telephone. 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. The fee plan incorporates 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 incorporates 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 total revenue to us at current or lower volume levels. If volume grows, total revenues could be less under the new plan than the previous plan due to the lower variable fees. For trades on our DealerAxess<sup>®</sup> 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<sup>®</sup> platform in their first year of trading. The majority of the DealerAxess<sup>®</sup> monthly minimum commitments expired as of June 30, 2007.

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*European High-Grade Corporate Bond Commissions* On June 1, 2007, we introduced a new fee plan for European high-grade corporate bond trades for the majority of our European dealers. Similar to the U.S. high-grade plan, the new European high-grade corporate bond fee plan incorporates fixed monthly fees and a variable fee that is lower than the transaction fee under the previous European high-grade plan and incorporates incentives to our broker-dealer clients that are designed to increase the volume of transactions effected on our platform. The variable fee under the new plan is dependent on the type of bond traded and the maturity of the issue. The combination of the fixed and variable fees in the new plan results in higher total revenue to us at current or lower volume levels. If volume grows, total revenues could be less under the new plan than the previous plan due to the lower variable fees. Under the fee plan in effect prior to June 1, 2007, broker-dealer transaction fees varied based on the type of bond traded and the maturity of the issue. This fee schedule applied a tiered fee structure, which reduced the fee per trade upon the attainment of certain specified amounts of monthly commissions generated by a particular broker-dealer and did not carry a fixed monthly fee.

*Other Commissions* Commissions for other bond trades generally vary based on the type and the maturity of the bond traded. We generally operate using standard fee schedules that may include both variable transaction fees and fixed monthly fees that are charged to the participating dealers. 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 on the platform.

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, license fees, income on investments and other services.

*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 services 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, generally 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 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 the fourth quarter of 2006, we commenced a \$40.0 million share repurchase program. Through September 30, 2007, we have expended a total of \$30.0 million under this program. Investment income may 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. In 2007, we also began providing technology consulting services. Fees for such services are charged based upon the complexity and extent of the services provided.

***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-based 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.

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*Depreciation and Amortization* We depreciate our computer hardware and related software, office hardware and furniture and fixtures 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.

*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. Unrecognized tax benefits as of January 1, 2007 and September 30, 2007 were \$2.7 million and \$2.8 million, respectively. 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.

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 nine months ended September 30, 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.

**Table of Contents****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.

**Statistical Information**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Trading Volume Data (in billions)				
U.S. high-grade multi dealer	\$ 37.3	\$ 44.7	\$ 155.7	\$ 124.4
U.S. high-grade single dealer	2.6	5.1	12.6	14.6
Total U.S. high-grade	39.9	49.8	168.3	139.0
European high-grade	14.8	18.7	66.9	65.5
Other	21.0	15.3	56.4	43.3
Total	\$ 75.7	\$ 83.8	\$ 291.6	\$ 247.8
Number of U.S. Trading Days	63	63	188	187
Number of U.K. Trading Days	64	64	189	188

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 September 30, 2007 and 2006, respectively) and our broker-dealer clients as of September 30, 2007 and 2006 were as follows:

	September 30,	
	2007	2006
Institutional Investor Clients:		
U.S.	474	452
Europe	217	231
Total	691	683
Broker-Dealer Clients	30	25

**Results of Operations**

*Three Months Ended September 30, 2007 Compared to Three Months Ended September 30, 2006*



*Overview*

Total revenues increased by \$1.4 million or 6.9% to \$22.2 million for the three months ended September 30, 2007 from \$20.8 million for the three months ended September 30, 2006. This increase in total revenues was primarily due to an increase in European high-grade commissions of \$1.6 million.

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Total expenses increased slightly to \$18.6 million for the three months ended September 30, 2007 from \$18.5 million for the three months ended September 30, 2006. Higher occupancy, marketing and advertising expenses totaling \$0.2 million were partially offset by lower employee compensation and benefits.

For the three months ended September 30, 2007, income before taxes increased by \$1.4 million or 63.4% to \$3.6 million compared to \$2.2 million for the three months ended September 30, 2006. Net income increased by \$1.1 million or 85.8% to \$2.4 million compared to \$1.3 million for three months ended September 30, 2006.

*Revenues*

Our revenues and percentage of revenues for the three months ended September 30, 2007 and 2006, and the resulting dollar and percentage changes, were as follows:

	2007		2006		\$ Change	% Change
	\$	% of Revenues	\$ (\$ in thousands)	% of Revenues		
<b>Revenues</b>						
<b>Commissions</b>						
U.S. high-grade	\$ 11,982	54.0%	\$ 12,250	59.0%	\$ (268)	(2.2)%
European high-grade	4,889	22.0	3,290	15.8	1,599	48.6
Other	2,107	9.5	2,057	9.9	50	2.4
Total commissions	18,978	85.5	17,597	84.7	1,381	7.8
<b>Information and user access</b>						
fees	1,535	6.9	1,426	6.9	109	7.6
License fees	90	0.4	247	1.2	(157)	(63.6)
Investment income	1,332	6.0	1,266	6.1	66	5.2
Other	263	1.2	238	1.1	25	10.5
Total revenues	\$ 22,198	100.0%	\$ 20,774	100.0%	\$ 1,424	6.9%

*Commissions.* Total commissions increased by \$1.4 million or 7.8% to \$19.0 million for the three months ended September 30, 2007 from \$17.6 million for the three months ended September 30, 2006. The following table shows the extent to which the increase in commissions for the three months ended September 30, 2007 as compared to the three months ended September 30, 2006 was attributable to changes in transaction volumes, variable fees per million, fixed monthly distribution fees and DealerAxess® minimum fees:

	Change from Three Months Ended September 30, 2006			
	U.S. High-Grade	European High-Grade	Other	Total
	(In thousands)			
Volume (decrease) increase	\$ (687)	\$ (686)	\$ 766	\$ (607)
Variable fee per million increase (decrease)	1,003	(1,139)	(716)	(852)
Fixed monthly distribution fees increase	495	3,424		3,919
DealerAxess® minimum fees decrease	(1,079)			(1,079)
Total commissions (decrease) increase	\$ (268)	\$ 1,599	\$ 50	\$ 1,381

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Our average fees per million for the three months ended September 30, 2007 and 2006 were as follows:

<b>Average Fee Per Million</b>	<b>Three Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
U.S. high-grade		
Total	\$ 300	\$ 246
Variable	\$ 95	\$ 69
European high-grade		
Total	\$ 330	\$ 176
Variable	\$ 99	\$ 176
Other	\$ 100	\$ 134
All Products	\$ 251	\$ 210

For the three months ended September 30, 2007, U.S. high-grade volume decreased by 19.9% compared to the three months ended September 30, 2006. The decrease in U.S. high-grade volume was due primarily to a decline 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 9.3% for the three months ended September 30, 2006 to 7.8% for the three months ended September 30, 2007, coupled with a decline in TRACE volume. The majority of the market share decline was attributable to a decrease in floating rate note volume, a sector of the market that was heavily impacted by the credit market turmoil. Estimated NASD TRACE U.S. high-grade volume decreased by 4.0% from \$533.9 billion for the three months ended September 30, 2006 to \$512.7 billion for the three months ended September 30, 2007. The fixed monthly U.S. high-grade distribution fees were \$8.0 million for the three months ended September 30, 2007, compared to \$7.6 million for the three months ended September 30, 2006. The DealerAxess® monthly minimum fees were \$0.2 million and \$1.2 million for the three months ended September 30, 2007 and 2006, respectively. The majority of the DealerAxess® minimum fee commitments expired as of June 30, 2007. The total U.S. high-grade average fee per million is calculated for each period presented using both the variable transaction fees and the fixed monthly distribution fees, including the DealerAxess® monthly minimum fees, paid by our broker-dealer clients. The variable U.S. high-grade average fee per million increased due to the longer maturity of trades executed on the platform, for which we charge higher commissions.

For the three months ended September 30, 2007, European high-grade volume decreased by 20.9%, net of a favorable effect of foreign currency changes, compared to the three months ended September 30, 2006. During the third quarter of 2007, we believe that the European credit markets experienced market conditions similar to the U.S. On June 1, 2007, we introduced a new fee plan for European high-grade corporate bond trades. Similar to the U.S. high-grade plan, the new European high-grade corporate bond fee plan incorporates a fixed monthly fee and a variable fee that is dependent on the type of bond traded and the maturity of the issue. The fixed monthly European high-grade distribution fee was \$3.4 million for the three months ended September 30, 2007. The total European high-grade average fee per million is calculated for each period presented using both the variable transaction fees and the fixed monthly distribution fees paid by our broker-dealer clients. The decrease in the variable European high-grade average fee per million for the three months ended September 30, 2007 as compared to the three months ended September 30, 2006 resulted principally from the introduction of the new European high-grade fee plan.

For the three months ended September 30, 2007, Other volume increased by 37.3%, compared to the three months ended September 30, 2006. The increase was primarily due to higher credit default swap, high-yield and agencies volume. Other average fee per million declined primarily due to higher volume in lower margin products, including credit default swap indexes and agencies.

*Information and User Access Fees.* Information and user access fees increased by \$0.1 million or 7.6% to \$1.5 million for the three months ended September 30, 2007 from \$1.4 million for the three months ended September 30, 2006.

*License Fees.* License fees decreased by \$0.2 million or 63.6% to \$0.1 million for the three months ended September 30, 2007 from \$0.2 million for the three months ended September 30, 2006.

*Investment Income.* Investment income was \$1.3 million for each of the three months ended September 30, 2007 and 2006.

*Other.* Other revenues increased by 10.5% to \$0.3 million for the three months ended September 30, 2007 from \$0.2 million for the three months ended September 30, 2006.

**Table of Contents***Expenses*

Our expenses and percentage of revenues for the three months ended September 30, 2007 and 2006, and the resulting dollar and percentage changes, were as follows:

	Three Months Ended September 30,					
	2007		2006		\$ Change	% Change
	\$	% of Revenues	\$	% of Revenues		
	(\$ in thousands)					
<b>Expenses</b>						
Employee compensation and benefits	\$ 10,258	46.2%	\$ 10,483	50.5%	\$ (225)	(2.1)%
Depreciation and amortization	1,686	7.6	1,703	8.2	(17)	(1.0)
Technology and communications	1,897	8.5	1,956	9.4	(59)	(3.0)
Professional and consulting fees	1,883	8.5	1,883	9.1		
Occupancy	869	3.9	778	3.7	91	11.7
Marketing and advertising	481	2.2	338	1.6	143	42.3
General and administrative	1,481	6.7	1,403	6.8	78	5.6
Total expenses	\$ 18,555	83.6%	\$ 18,544	89.3%	\$ 11	0.1%

*Employee Compensation and Benefits.* Employee compensation and benefits decreased by \$0.2 million or 2.1% to \$10.3 million for the three months ended September 30, 2007 from \$10.5 million for the three months ended September 30, 2006. This decrease was primarily attributable to reduced severance costs of \$0.6 million, offset by higher incentive compensation of \$0.4 million.

*Depreciation and Amortization.* Depreciation and amortization expense was \$1.7 million for each of the three months ended September 30, 2007 and 2006. For the three months ended September 30, 2007 and 2006, we capitalized \$0.9 million and \$0.8 million, respectively, of software development costs and \$0.5 million and \$0.8 million, respectively, of computer and related equipment purchases.

*Technology and Communications.* Technology and communications expense decreased by \$0.1 million or 3.0% to \$1.9 million for the three months ended September 30, 2007 from \$2.0 million for the three months ended September 30, 2006. This decrease was attributable to lower software license and maintenance costs.

*Professional and Consulting Fees.* Professional and consulting fees were \$1.9 million for each of the three months ended September 30, 2007 and 2006. Increases in recruiting and legal costs totaling \$0.3 million were offset by lower information technology and non-technology consultant costs.

*Occupancy.* Occupancy costs increased by \$0.1 million or 11.7% to \$0.9 million for the three months ended September 30, 2007 from \$0.8 million for the three months ended September 30, 2006, primarily due to rent expense for additional leased space in New York City.

*Marketing and Advertising.* Marketing and advertising expense increased by \$0.1 million or 42.3% to \$0.5 million for the three months ended September 30, 2007 from \$0.3 million for the three month periods ended September 30, 2006, primarily due to higher public relations cost.

*General and Administrative.* General and administrative expense increased by \$0.1 million or 5.6% to \$1.5 million for the three months ended September 30, 2007 from \$1.4 million for the three months ended September 30, 2006, primarily due to higher travel and entertainment expense.

*Provision for Income Tax.* For the three months ended September 30, 2007 and 2006, we recorded an income tax provision of \$1.2 million and \$0.9 million, respectively. The increase in the tax provision was primarily attributable to

the \$1.4 million increase in pre-tax income for the period. With the exception of the payment of certain state and local taxes, the provision for income taxes was a non-cash expense since we had available net operating loss carryforwards and tax credits to offset the cash payment of taxes.

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Our consolidated effective tax rate for the three months ended September 30, 2007 was 33.9% compared to 41.8% for the three months ended September 30, 2006. The decrease in the effective tax rate was principally attributable to an increase in foreign earnings in 2007. Our consolidated effective tax rate can vary from period to period depending on, among other factors, the geographic and business mix of our earnings and change in tax legislation.

***Nine Months Ended September 30, 2007 Compared to Nine Months Ended September 30, 2006******Overview***

Total revenues increased by \$10.0 million or 16.4% to \$71.3 million for the nine months ended September 30, 2007 from \$61.2 million for the nine months ended September 30, 2006. This increase in total revenues was primarily due to increases in total commissions of \$8.8 million, investment income of \$0.5 million and other revenues of \$0.6 million.

Total expenses increased by \$0.9 million or 1.6% to \$57.1 million for the nine months ended September 30, 2007 from \$56.2 million for the nine months ended September 30, 2006. This increase was primarily due to higher employee compensation and benefits of \$1.5 million and depreciation and amortization of \$0.5 million, offset by a decline in professional and consulting fees of \$1.4 million.

For the nine months ended September 30, 2007, income before taxes increased by \$9.1 million or 182.1% to \$14.1 million compared to \$5.0 million for the nine months ended September 30, 2006. Net income increased by \$5.2 million or 164.3% to \$8.4 million compared to \$3.2 million for the nine months ended September 30, 2006.

***Revenues***

Our revenues and percentage of revenues for the nine months ended September 30, 2007 and 2006, and the resulting dollar and percentage changes, were as follows:

	2007		2006		\$ Change	% Change
	\$	% of Revenues	\$ (\$ in thousands)	% of Revenues		
<b>Revenues</b>						
Commissions						
U.S. high-grade	\$ 40,196	56.4%	\$ 34,254	55.9%	\$ 5,942	17.3%
European high-grade	14,099	19.8	11,717	19.1	2,382	20.3
Other	6,832	9.6	6,371	10.4	461	7.2
Total commissions	61,127	85.8	52,342	85.5	8,785	16.8
Information and user access fees	4,357	6.1	4,108	6.7	249	6.1
License fees	658	0.9	742	1.2	(84)	(11.3)
Investment income	3,812	5.3	3,312	5.4	500	15.1
Other	1,313	1.8	732	1.2	581	79.4
Total revenues	\$ 71,267	100.0%	\$ 61,236	100.0%	\$ 10,031	16.4%

**Commissions.** Total commissions increased by \$8.8 million or 16.8% to \$61.1 million for the nine months ended September 30, 2007 from \$52.3 million for the nine months ended September 30, 2006. The following table shows the extent to which the increase in commissions for the nine months ended September 30, 2007 as compared to the nine months ended September 30, 2006 was attributable to changes in transaction volumes, variable fees per million, fixed monthly distribution fees and DealerAxess® minimum fees:





For the nine months ended September 30, 2007, Other volume increased by 30.3% compared to the nine months ended September 30, 2006. The increase was primarily due to higher credit default swap, high-yield and agencies volume. Other average fee per million declined primarily due to higher volume in lower margin products, including credit default swap and agencies.

*Information and User Access Fees.* Information and user access fees increased by \$0.2 million or 6.1% to \$4.4 million for the nine months ended September 30, 2007 from \$4.1 million for the nine months ended September 30, 2006.

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*License Fees.* License fees were \$0.7 million for each of the nine months ended September 30, 2007 and 2006.

*Investment Income.* Investment income increased by \$0.5 million or 15.1% to \$3.8 million for the nine months ended September 30, 2007 from \$3.3 million for the nine months ended September 30, 2006. This increase was primarily due to higher Cash and cash equivalents and Securities available-for-sale balances, which include the effect of the share repurchase program, and a rise in interest rates during the nine months ended September 30, 2007 as compared to the nine months ended September 30, 2006.

*Other.* Other revenues increased by \$0.6 million or 79.4% to \$1.3 million for the nine months ended September 30, 2007 from \$0.7 million for the nine months ended September 30, 2006. Other revenues in 2007 included \$0.6 million in revenue recognized under a technology development contract with a broker-dealer client.

*Expenses*

Our expenses and percentage of revenues for the nine months ended September 30, 2007 and 2006, and the resulting dollar and percentage changes, were as follows:

	Nine Months Ended September 30,					
	2007		2006		\$ Change	% Change
	\$	% of Revenues	\$ (\$ in thousands)	% of Revenues		
<b>Expenses</b>						
Employee compensation and benefits	\$ 32,771	46.0%	\$ 31,264	51.1%	\$ 1,507	4.8%
Depreciation and amortization	5,476	7.7	5,025	8.2	451	9.0
Technology and communications	5,595	7.9	5,799	9.5	(204)	(3.5)
Professional and consulting fees	5,505	7.7	6,922	11.3	(1,417)	(20.5)
Occupancy	2,423	3.4	2,270	3.7	153	6.7
Marketing and advertising	1,364	1.9	1,193	1.9	171	14.3
General and administrative	3,982	5.6	3,748	6.1	234	6.2
Total expenses	\$ 57,116	80.1%	\$ 56,221	91.8%	\$ 895	1.6%

*Employee Compensation and Benefits.* Employee compensation and benefits increased by \$1.5 million or 4.8% to \$32.8 million for the nine months ended September 30, 2007 from \$31.3 million for the nine months ended September 30, 2006. This increase was primarily attributable to higher cash incentive compensation of \$2.6 million and increased payroll taxes of \$0.8 million. These increases were offset by reductions in wages of \$1.0 million, stock-based compensation costs of \$0.4 million and severance costs of \$0.6 million.

*Depreciation and Amortization.* Depreciation and amortization expense increased by \$0.5 million or 9.0% to \$5.5 million for the nine months ended September 30, 2007 from \$5.0 million for the nine months ended September 30, 2006. This increase was attributable to increased amortization of capitalized software development costs for our credit default swap and DealerAxess® products. For the nine months ended September 30, 2007 and 2006, we capitalized \$2.6 million and \$2.8 million, respectively, of software development costs and \$1.1 million and \$2.3 million, respectively, of computer and related equipment purchases.

*Technology and Communications.* Technology and communications expense decreased by \$0.2 million or 3.5% to \$5.6 million for the nine months ended September 30, 2007 from \$5.8 million for the nine months ended September 30, 2006. This decrease was attributable to lower maintenance and office hardware costs.

*Professional and Consulting Fees.* Professional and consulting fees decreased by \$1.4 million or 20.5% to \$5.5 million for the nine months ended September 30, 2007 from \$6.9 million for the nine months ended

September 30, 2006. This decrease was primarily due to lower information technology and non-technology consulting costs of \$1.1 million and accounting and tax fees of \$0.8 million, offset by higher recruiting fees of \$0.6 million.

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*Occupancy.* Occupancy costs increased by \$0.2 million or 6.7% to \$2.4 million for the nine months ended September 30, 2007 from \$2.3 million for the nine months ended September 30, 2006, primarily due to rent expense for additional leased space.

*Marketing and Advertising.* Marketing and advertising expense increased by \$0.2 million or 14.3% to \$1.4 million for the nine months ended September 30, 2007 from \$1.2 million for the nine months ended September 30, 2006, primarily due to higher public relations and promotional expenses.

*General and Administrative.* General and administrative expense increased by \$0.2 million or 6.2% to \$4.0 million for the nine months ended September 30, 2007 from \$3.7 million for the nine months ended September 30, 2006, primarily due to higher travel and entertainment expense.

*Provision for Income Tax.* For the nine months ended September 30, 2007 and 2006, we recorded an income tax provision of \$5.7 million and \$1.8 million, respectively. The increase in the tax provision was primarily attributable to the \$9.1 million increase in pre-tax income for the period. With the exception of the payment of certain state and local taxes, the provision for income taxes was a non-cash expense since we had available net operating loss carryforwards and tax credits to offset the cash payment of taxes.

Our consolidated effective tax rate for the nine months ended September 30, 2007 was 40.6% compared to 36.5% for the nine months ended September 30, 2006. The 2007 provision includes an adjustment to the deferred tax asset balance of \$0.5 million to reflect the tax rate anticipated to be in effect when temporary differences are expected to reverse, as well as changes in an enacted state and foreign tax rates. This adjustment increased the effective tax rate for the nine months ended September 30, 2007 by 3.1 percentage points. The 2006 tax provision included an adjustment to the deferred tax liability of \$0.2 million, which reduced the effective tax rate by 3.2 percentage points. Our consolidated effective tax rate can vary from period to period depending on, among other factors, the geographic and business mix of our earnings and change in tax legislation.

**Liquidity and Capital Resources**

Since our inception, we have met our funding requirements through the issuance of our preferred stock, internally generated funds and our initial public offering in November 2004. Cash and cash equivalents and Securities available-for-sale totaled \$127.8 million as of September 30, 2007. We have no long-term or short-term debt and do not maintain bank lines of credit.

On October 26, 2006, our Board of Directors authorized a stock repurchase program for up to \$40.0 million of our common stock. Shares repurchased under the program will be held in treasury for future use. During the nine months ended September 30, 2007, a total of 1,921,697 shares were repurchased at a cost of \$27.4 million. A total of 2,112,197 shares have been repurchased at an aggregate cost of \$30.0 million from the inception of the repurchase program through September 30, 2007.

Our cash flows for the periods presented below were as follows:

	<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>
	<b>(In thousands)</b>	
Net cash provided by operating activities	\$ 22,330	\$ 8,079
Net cash used in investing activities	(8,145)	(3,265)
Net cash (used in) provided by financing activities	(21,668)	2,592
Effect of exchange rate changes on cash	(167)	(302)
Net (decrease) increase for the period	\$ (7,650)	\$ 7,104

**Operating Activities**

Net cash provided by operating activities of \$22.3 million for the nine months ended September 30, 2007 consisted of net income of \$8.4 million, adjusted for non-cash charges, primarily consisting of depreciation and amortization of \$5.5 million, stock-based compensation expense of \$4.1 million and deferred taxes of \$5.3 million, offset by an

increase in cash used for working capital of \$1.3 million. The use of working capital primarily resulted from an increase in accounts receivable of \$2.5 million and decrease in accrued employee compensation of \$1.3 million partially offset by a decline in accounts payable, accrued expenses and other liabilities of \$1.4 million.

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Net cash provided by operating activities of \$8.1 million for the nine months ended September 30, 2006 consisted of net income of \$3.2 million, adjusted for non-cash charges, primarily consisting of depreciation and amortization of \$5.0 million, stock-based compensation expense of \$4.5 million, and deferred taxes of \$0.8 million offset by an increase in cash used for working capital of \$6.0 million. The use of working capital primarily resulted from an increase in accounts receivable of \$4.5 million.

***Investing Activities***

Net cash used in investing activities of \$8.1 million for the nine months ended September 30, 2007 primarily consisted of net purchases of securities available-for-sale of \$4.4 million, purchases of furniture, equipment and leasehold improvements of \$1.1 million and capitalization of software development costs of \$2.6 million.

Net cash used in investing activities of \$3.3 million for the nine months ended September 30, 2006 primarily consisted of net purchases of securities-available-for-sale of \$1.8 million, purchases of furniture, equipment and leasehold improvements of \$2.3 million and capitalization of software development costs of \$2.8 million.

***Financing Activities***

Net cash used in financing activities of \$21.7 million for the nine months ended September 30, 2007 primarily consisted of the purchase of treasury stock of \$27.4 million, offset by proceeds from the exercise of stock options and issuance of restricted stock of \$5.1 million.

Net cash provided by financing activities of \$2.6 million for the nine months ended September 30, 2006 consisted of proceeds from the exercise of stock options and issuance of restricted stock of \$1.5 million and excess tax benefits of \$1.1 million.

Past trends of cash flows are not necessarily indicative of future cash flow levels. A decrease in cash flows may have a material adverse effect on our liquidity, business and financial condition.

***Other Factors Influencing Liquidity and Capital Resources***

We are dependent on our broker-dealer clients, seven of which were also our stockholders as of January 1, 2007 who are not restricted from buying and selling fixed-income securities, directly or through their own proprietary or third-party platforms, with institutional investors. None of our broker-dealer clients is contractually or otherwise obligated to continue to use our electronic trading platform. The loss of, or a significant reduction in the use of our electronic platform by, our broker-dealer clients could reduce our cash flows, affect our liquidity and have a material adverse effect on our business, financial condition and results of operations.

We believe that our current resources are adequate to meet our liquidity needs and capital expenditure requirements for at least the next 12 months. However, our future liquidity and capital requirements will depend on a number of factors, including expenses associated with product development and expansion and new business opportunities that are intended to further diversify our revenue stream. We may also acquire or invest in technologies, business ventures or products that are complementary to our business. In the event we require any additional financing, it will take the form of equity or debt financing. Any additional equity offerings may result in dilution to our stockholders. Any debt financings may involve restrictive covenants with respect to dividends, issuances of additional capital and other financial and operational matters related to our business.

We have two major operating subsidiaries, MarketAxess Corporation and MarketAxess Europe Limited. MarketAxess Corporation is a registered broker-dealer in the U.S. and MarketAxess Europe Limited is a registered alternative trading system in the U.K. As such, they are subject to minimum regulatory capital requirements imposed by their respective market regulators that are intended to ensure general financial soundness and liquidity based on certain minimum capital requirements. The U.S. and the U.K. regulations prohibit a registrant from repaying borrowings from its parent or affiliates, paying cash dividends, making loans to its parent or affiliates or otherwise entering into transactions that result in a significant reduction in its regulatory net capital position without prior notification to or approval from its principal regulator. The capital structures of our subsidiaries are designed to provide each with capital and liquidity consistent with its business and regulatory requirements. As of September 30, 2007, MarketAxess Corporation had net capital of \$18.6 million, which was \$17.5 million in excess of its required minimum net capital of \$1.0 million. MarketAxess Europe Limited had financial resources, as defined by the FSA, of \$17.7 million, which was \$10.0 million in excess of its required financial resources of \$7.7 million.



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In June 2006, our U.S. subsidiary, 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 September 30, 2007, 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 counterparty 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. As of September 30, 2007, MarketAxess Corporation recorded no contingent liabilities with regard to this right. In the ordinary course of business, we enter into contracts that contain a variety of representations, warranties and general indemnifications. Our maximum exposure from any claims under these arrangements is unknown, as this would involve claims that have not yet occurred. However, based on past experience, we expect the risk of loss to be remote.

**Effects of Inflation**

Because the majority of our assets are short-term in nature, they are not significantly affected by inflation. However, the rate of inflation may affect our expenses, such as employee compensation, office leasing costs and communications expenses, which may not be readily recoverable in the prices of our services. To the extent inflation results in rising interest rates and has other adverse effects on the securities markets, it may adversely affect our financial position and results of operations.

**Contractual Obligations and Commitments**

As of September 30, 2007, we had the contractual obligations and commitments detailed in the following table:

	Total	Payments due by period			
		Less than 1 year	1 to 3 years (In thousands)	3 to 5 years	More than 5 years
Operating leases	\$ 11,927	\$ 636	\$ 5,108	\$ 2,445	\$ 3,738
Foreign currency forward contracts	20,992	20,992			
	\$ 32,919	\$ 21,628	\$ 5,108	\$ 2,445	\$ 3,738

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the risk of loss resulting from adverse changes in market rates and prices, such as interest rates and foreign currency exchange rates.

**Market Risk**

The global financial services business is, by its nature, risky and volatile and is directly affected by many national and international factors that are beyond our control. Any one of these factors may cause a substantial decline in the U.S. and global financial services markets, resulting in reduced trading volume. These events could have a material adverse effect on our business, financial condition and results of operations.

As of September 30, 2007, we had Securities available-for-sale of \$53.4 million. Adverse movements, such as a 10% decrease in these securities or a downturn or disruption in the markets for these securities, could result in a substantial loss. In addition, principal gains and losses resulting from these securities could on occasion have a disproportionate effect, positive or negative, on our financial condition and results of operations for any particular



reporting period.

**Table of Contents*****Interest Rate Risk***

Interest rate risk represents our exposure to interest rate changes with respect to the money market instruments, U.S. Treasury obligations and short-term fixed-income securities in which we invest. As of September 30, 2007, our Cash and cash equivalents and Securities available-for-sale amounted to \$127.8 million and was primarily in money market instruments, federal agency issues and municipal securities. We do not maintain an inventory of bonds that are traded on our platform.

***Derivative Risk***

Our limited derivative risk stems from our activities in the foreign currency forward contract market. We use this market to mitigate our U.S. dollar versus Pound Sterling exposure that arises from the investment of our U.K. Subsidiaries. As of September 30, 2007, the notional value of our foreign currency forward contracts was \$21.0 million. We do not speculate in any derivative instruments.

***Credit Risk***

In June 2006, we began executing riskless principal transactions between our broker-dealer clients through our subsidiary, MarketAxess Corporation. We act as an intermediary in these transactions by serving as counterparty to both the buyer and the seller in matching back-to-back trades, which are then settled through a third-party clearing organization. Settlement typically occurs within one to three trading days after the trade date. Cash settlement of the transaction occurs upon receipt or delivery of the underlying instrument that was traded.

We are exposed to credit risk in our role as trading counterparty to our broker-dealer clients executing trades on the DealerAxess® platform. We are exposed to the risk that third parties that owe us money, securities or other assets will not perform their obligations. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, operational failure or other reasons. Adverse movements in the prices of securities that are the subject of these transactions can increase our risk. Where the unmatched position or failure to deliver is prolonged, there may also be regulatory capital charges required to be taken by us. The policies and procedures we use to manage this credit risk are new and untested. There can be no assurance that these policies and procedures will effectively mitigate our exposure to credit risk.

**Item 4. Controls and Procedures**

(a) *Evaluation of Disclosure Controls and Procedures.* Our management, including the Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as that term is defined in Rule 13a-15(e) and Rule 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of September 30, 2007. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective to ensure that information required to be disclosed by MarketAxess in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and to ensure that information is accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

(b) *Changes in Internal Control Over Financial Reporting.* There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) and Rule 15d-15(f) under the Exchange Act) during the quarter ended September 30, 2007 identified in connection with the evaluation thereof by our management, including the Chief Executive Officer and Chief Financial Officer, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II Other Information****Item 1. Legal Proceedings**

In January 2007, two former employees commenced arbitration proceedings against us before the NASD 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 we wrongfully prevented him from exercising his vested options when he sought to do so and that we wrongfully claimed that such options had expired on the previous day.



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The other former employee has alleged that we 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 our 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 us during 2006.

We believe that both cases are without merit and we intend to vigorously defend them. We answered both arbitration claims during March 2007. Based on currently available information, we believe 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.

**Item 1A. Risk Factors**

Risks that could have a negative impact on our business, results of operations and financial condition include: our dependence on our broker-dealer clients, seven of which were also our stockholders as of January 1, 2007; the level and intensity of competition in the fixed-income electronic trading industry and the pricing pressures that may result; the variability of our growth rate; our limited operating history; the level of trading volume transacted on the MarketAxess platform; potential fluctuations in our operating results which may cause our stock price to decline; the absolute level and direction of interest rates and the corresponding volatility in the corporate fixed-income market; our ability to develop new products and offerings and the market's acceptance of those products; technology failures, security breaches or rapid technology changes that may harm our business; our ability to enter into strategic alliances and to acquire other businesses and successfully integrate them with our business; extensive government regulation; continuing international expansion that may present economic and regulatory challenges; and our future capital needs and our ability to obtain capital when needed. This list is intended to identify only certain of the principal factors that could have a material adverse impact on our business, results of operations and financial condition. A more detailed description of each of these and other important risk factors can be found under the caption "Risk Factors" in our most recent Form 10-K, filed on March 14, 2007. There have been no material changes to the risk factors described in the Form 10-K.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds****Issuer Purchases of Equity Securities**

During the quarter ended September 30, 2007, we repurchased the following shares of our common stock:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans	Dollar Value of Shares That May Yet Be Purchased Under the Plans
				(In Thousands)
July 1, 2007 – July 31, 2007	105,000	\$ 18.79	105,000	\$ 11,517
August 1, 2007 – August 31, 2007	30,000	17.61	30,000	10,989
September 1, 2007 – September 30, 2007	69,840	14.58	69,840	9,970
	204,840	\$ 17.18	204,840	

On October 26, 2006, our Board of Directors authorized a stock repurchase program for up to \$40.0 million of our common stock. We have repurchased and may continue to repurchase the shares in the open market or privately negotiated transactions, at times and prices considered appropriate by us depending upon prevailing market conditions. Shares repurchased under the program will be held in treasury for future use. A total of 2,112,197 shares have been repurchased at an aggregate cost of \$30.0 million from the inception of the repurchase program through

September 30, 2007.

**Item 3. Defaults upon Senior Securities**

None

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**Item 4. *Submission of Matters to a Vote of Security Holders***

None

**Item 5. *Other Information***

None

**Item 6. *Exhibits***

Exhibit Listing

<b>Number</b>	<b>Description</b>
31.1	Certification by Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification by Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification by Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification by Chief Financial Officer 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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**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1933, as amended, the registrant has duly caused this Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

MARKETAXESS HOLDINGS INC.

Date: November 1, 2007

By: /s/ RICHARD M. MCVEY  
Richard M. McVey  
Chief Executive Officer  
(principal executive officer)

Date: November 1, 2007

By: /s/ JAMES N.B. RUCKER  
James N. B. Rucker  
Chief Financial Officer  
(principal financial and accounting  
officer)