

THE NASDAQ STOCK MARKET, INC

Consolidated Financial Statements

December 31, 1999 and 1998 and the three years in the period ended December 31,
1999 with Report of Independent Auditors

The Nasdaq Stock Market, Inc.

**December 31, 1999 and 1998
and the three years in the period
ended December 31, 1999**

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Report of Independent Auditors


Board of Directors
The Nasdaq Stock Market, Inc.

We have audited the accompanying consolidated balance sheets of The Nasdaq Stock Market, Inc. (a wholly owned subsidiary of the National Association of Securities Dealers, Inc.) as of December 31, 1999 and 1998, and the related consolidated statements of income, changes in stockholder's equity, and cash flows for each of the three years in the period ended December 31, 1999. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of The Nasdaq Stock Market, Inc. at December 31, 1999 and 1998, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1999, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 1999, the Company adopted Statement of Position 98-1 "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use."



January 21, 2000

The Nasdaq Stock Market, Inc.

Consolidated Balance Sheets
(In thousands)

	December 31,	
	1999	1998
Assets		
Current assets:		
Cash and cash equivalents	\$ 10,598	\$ 2,754
Investments:		
Available-for-sale, at fair value	153,566	129,881
Held-to-maturity, at amortized cost	10,697	11,582
Receivables, net	112,403	72,506
Receivables from related parties (note 10)	7,168	9,665
Other current assets	12,701	3,946
Total current assets	307,133	230,334
Investments:		
Held-to-maturity, at amortized cost	17,720	16,588
Property and equipment:		
Land, buildings and improvements	56,173	54,202
Data processing equipment and software	246,999	188,289
Furniture, equipment and leasehold improvements	101,658	53,897
	404,830	296,388
Less accumulated depreciation	(192,719)	(147,028)
Total property and equipment, net	212,111	149,360
Investments in warrants, at cost	33,480	-
Other assets	2,597	7,463
Total assets	\$ 573,041	\$ 403,745

See accompanying notes to consolidated financial statements.

The Nasdaq Stock Market, Inc.

Consolidated Balance Sheets
(In thousands)

	December 31,	
	1999	1998
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	\$ 68,585	\$ 49,770
Accrued personnel costs	30,505	20,845
Deferred revenue	9,787	8,374
Other accrued liabilities	12,747	10,178
Due to banks	8,819	4,943
Payables to related parties (note 10)	11,742	3,811
Total current liabilities	<u>142,185</u>	<u>97,921</u>
Long-term debt	25,000	25,000
Accrued pension costs	7,073	4,566
Deferred revenue, investments in warrants, at cost	33,480	-
Other liabilities	13,291	10,117
Total long-term liabilities	<u>78,844</u>	<u>39,683</u>
Total liabilities	221,029	137,604
Stockholder's equity		
Common stock, no par value, 2,000 authorized, issued, and outstanding	-	-
Paid-in capital	1,149	1,149
Unrealized gains on available-for-sale investments, net of tax	1,742	2,020
Retained earnings	349,121	262,972
Total stockholder's equity	<u>352,012</u>	<u>266,141</u>
Total liabilities and stockholder's equity	<u>\$ 573,041</u>	<u>\$ 403,745</u>

See accompanying notes to consolidated financial statements.

The Nasdaq Stock Market, Inc.

Consolidated Statements of Income
(In thousands, except per share amounts)

	Years ended December 31,		
	1999	1998	1997
Revenue			
Transaction service fees	\$ 215,831	\$ 126,913	\$ 141,384
Market information fees	187,175	152,665	126,436
Issuer fees	163,425	137,344	113,019
Interest and other	12,197	9,577	10,052
Total revenue	578,628	426,499	390,891
Expenses			
Compensation and benefits	98,129	78,565	64,324
Marketing and advertising	62,790	42,483	53,817
Depreciation	43,696	34,984	31,336
Professional and contract services	35,282	35,127	22,259
Computer operations and data communications	32,672	38,518	28,081
Other	24,809	16,704	14,560
Travel, meetings and training	10,230	7,750	7,310
Occupancy	6,591	5,354	4,883
Publications, supplies and postage	4,670	5,208	5,223
Total direct expenses	318,869	264,693	231,793
Support cost from related parties, net (note 10)	115,189	100,841	85,880
Total expenses	434,058	365,534	317,673
Income before provision for income taxes	144,570	60,965	73,218
Provision for income taxes	58,421	26,010	33,187
Net income	\$ 86,149	\$ 34,955	\$ 40,031
Pro forma basic earnings per common share¹	\$.86	\$.35	\$.40

⁽¹⁾ Gives effect to the 50,000-for-one stock split anticipated as part of the reorganization (note 12).

See accompanying notes to consolidated financial statements.

The Nasdaq Stock Market, Inc.

Consolidated Statement of Changes in Stockholder's Equity
(In thousands, except share amounts)

	Number of Shares Outstanding	Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
Balance, December 31, 1996	2,000	\$ 1,149	\$ 187,986	\$ -	\$ 189,135
Net income	-	-	40,031	-	40,031
Balance, December 31, 1997	2,000	1,149	228,017	-	229,166
Net income	-	-	34,955	-	34,955
Unrealized gains on available-for-sale investments, net of tax of \$1,088	-	-	-	2,020	2,020
Comprehensive income					36,975
Balance, December 31, 1998	2,000	1,149	262,972	2,020	266,141
Net income	-	-	86,149	-	86,149
Unrealized losses on available-for-sale investments, net of tax of (\$149)	-	-	-	(278)	(278)
Comprehensive income					85,871
Balance, December 31, 1999	2,000	\$ 1,149	\$ 349,121	\$ 1,742	\$ 352,012

See accompanying notes to consolidated financial statements.

The Nasdaq Stock Market, Inc.

Consolidated Statement of Cash Flows (In thousands)

	Years Ended December 31,		
	1999	1998	1997
Cash flow from operating activities			
Cash received from customers	\$ 527,946	\$ 400,918	\$ 365,586
Cash paid to suppliers and employees	(248,173)	(212,006)	(192,904)
Cash paid to related parties, net	(104,761)	(109,563)	(80,238)
Income taxes paid	(49,992)	(24,131)	(29,074)
Interest received, net	10,320	7,699	9,043
Other	(715)	(6,194)	4,342
Cash provided by operating activities	134,625	56,723	76,755
Cash flow from investing activities			
Proceeds from redemptions of available-for-sale investments	107,328	-	-
Purchases of available-for-sale investments	(131,291)	-	-
Proceeds from maturities of held-to-maturity investments	30,743	100,845	59,317
Purchases of held-to-maturity investments	(30,990)	(129,624)	(104,300)
Purchases of property and equipment, net	(106,447)	(29,371)	(78,081)
Cash used in investing activities	(130,657)	(58,150)	(123,064)
Cash flow from financing activities			
Increase in due to banks	3,876	156	4,766
Proceeds from acquisition of long-term debt	-	-	25,000
Cash provided by financing activities	3,876	156	29,766
Increase (decrease) in cash and cash equivalents	7,844	(1,271)	(16,543)
Cash and cash equivalents at beginning of year	2,754	4,025	20,568
Cash and cash equivalents at end of year	\$ 10,598	\$ 2,754	\$ 4,025
Reconciliation of net income to net cash provided by operating activities			
Net income	\$ 86,149	\$ 34,955	\$ 40,031
Depreciation	43,696	34,984	31,336
Increase in receivables	(39,897)	(18,762)	(10,284)
Decrease (increase) in receivables from related parties	2,497	(6,670)	248
Increase in other current assets	(8,755)	(380)	(140)
Decrease (increase) in other assets	4,866	(4,688)	(636)
Increase in accounts payable and accrued expenses	18,815	7,607	7,305
Increase in accrued personnel costs	9,660	3,966	6,893
Increase (decrease) in deferred revenue	1,413	2,758	(4,969)
Increase (decrease) in other accrued liabilities	2,569	9,545	(1,201)
Increase (decrease) in payables to related parties	7,931	(2,052)	5,394
Increase (decrease) in accrued pension	2,507	(3,414)	(2,340)
Increase (decrease) in other liabilities	3,174	(1,126)	5,118
Cash provided by operating activities	\$ 134,625	\$ 56,723	\$ 76,755

See accompanying notes to consolidated financial statements.

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements

(In thousands, except share amounts)

1. Organization and Nature of Operations

The Nasdaq Stock Market, Inc. ("Nasdaq") is the parent company of Nasdaq International Market Initiatives, Inc. ("NIMI"); Quadsan Enterprises, Inc. ("Quadsan"); and Nasdaq Investment Product Services, Inc. ("NIPS"); collectively referred to as Nasdaq. Nasdaq, which has headquarters in Washington, D.C. and New York, operates, along with the American Stock Exchange LLC ("Amex"), as part of The Nasdaq-Amex Market Group ("Market Group"), a holding company which is a subsidiary of the National Association of Securities Dealers, Inc. (the "NASD"). Nasdaq's 2,000 authorized and issued shares of common stock are held by Market Group. These shares are voting and have no par value.

Nasdaq uses a multiple market maker system to operate an electronic, screen-based equity market. Nasdaq's principal business products are price discovery and trading services, listing of issues, and the sale of related data and information. The majority of this business is transacted with listed companies and firms in the broker/dealer industry within the United States.

NIMI, which is based in Washington, D.C., offers a variety of consulting services to assist emerging and established securities markets around the world with both technology applications and regulation. Quadsan is a Delaware Investment Holding Company. NIPS is the sponsor of the Nasdaq-100 Trust, Series I.

2. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Nasdaq and its wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include demand cash and all non-restricted investments purchased with a remaining maturity of three months or less at the time of purchase.

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements (In thousands, except share amounts)

2. Summary of Significant Accounting Policies (continued)

Investments

Under Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities," management determines the appropriate classification of investments at the time of purchase. Investments for which the Company does not have the intent or ability to hold to maturity are classified as "available-for-sale" and are carried at fair market value, with the unrealized gains and losses, net of tax, reported as a separate component of Stockholder's Equity. Investments for which the Company has the intent and ability to hold to maturity are classified as "held-to-maturity" and are carried at amortized cost. The amortized cost of debt securities classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts. Realized gains and losses on sales of securities are included in earnings using the specific identification method.

A decline in the market value of any available-for-sale or held-to-maturity security below cost, that is deemed to be other than temporary, results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established.

Receivables, Net

Nasdaq's receivables are concentrated with NASD member firms and Nasdaq issuers. Receivables are shown net of reserves for uncollectible accounts. Reserves are calculated based on the age and source of the underlying receivable and are tied to past collections experience. Total reserves netted against receivables in the consolidated balance sheets were \$3.0 million and \$3.6 million at December 31, 1999 and 1998, respectively.

Property and Equipment

Property and equipment are recorded at cost less accumulated depreciation. Equipment acquired under capital leases is recorded at the lower of fair market value or the present value of future lease payments. Depreciation and amortization are provided on the straight-line method. Estimated useful lives generally range from 10 years to 40 years for buildings and improvements, 2 years to 5 years for data processing equipment and software, and 5 years to 10 years for furniture and equipment. Leasehold improvements are amortized using the straight-line method over the lesser of the useful life of the improvement or the term of the applicable lease.

Revenue Recognition

Market information services revenues are based on the number of presentation devices in service and quotes delivered through those devices. Market information services revenues are recognized in the month that information is provided. Transaction services revenues are variable based on service volumes and are recognized as transactions occur. Issuer annual listing services are

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements
(In thousands, except share amounts)

2. Summary of Significant Accounting Policies (continued)

Revenue Recognition (continued)

recognized as revenue evenly over the course of the year. Issuer entry and additional shares listings are recognized when applications are approved for listing on Nasdaq.

Deferred Revenue

Deferred revenue represents cash received and billed receivables which are unearned, until services are provided.

Pensions and Other Postretirement Benefits

Nasdaq adopted SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits" in fiscal year 1998. The provisions of this Statement revise employers' disclosures about pension and other postretirement benefit plans. It does not change the measurement or recognition of expense for these plans.

Advertising Costs

The Company expenses advertising costs, which included media advertising and production cost, in the periods in which the costs are incurred. Media advertising and production costs included as marketing in the consolidated statements of income totaled \$45.3 million, \$36.2 million and \$49.0 million for the year ended December 31, 1999, 1998 and 1997, respectively.

Software Costs

Significant purchased application software, and operational software that is an integral part of computer hardware, are capitalized and amortized on the straight-line method over their estimated useful lives. All other purchased software is charged to expense as incurred.

The Company adopted Statement of Position ("SOP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use" effective January 1, 1999. The provisions of this SOP require certain costs incurred in connection with developing or obtaining internal use software to be capitalized. Prior to January 1, 1999, Nasdaq expensed such costs as incurred. Under SOP 98-1, Nasdaq, as of December 31, 1999 capitalized approximately \$13.6 million net of amortization of \$0.5 million.

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements (In thousands, except share amounts)

2. Summary of Significant Accounting Policies (continued)

Income Taxes

Nasdaq and its subsidiaries are taxable entities. Deferred tax assets and liabilities are determined based on differences between the financial statement carrying amounts and the tax basis of existing assets and liabilities (i.e., temporary differences) and are measured at the enacted rates that will be in effect when these differences reverse. Nasdaq's tax liability is included in the consolidated return of Market Group.

Comprehensive Income

The Company adopted SFAS No. 130, "Reporting Comprehensive Income" in fiscal year 1998. SFAS 130 establishes new rules for the reporting and display of comprehensive income and its components; however, the adoption of this Statement had no impact on the Company's net income or stockholder's equity. SFAS 130 requires unrealized gains and losses on the Company's available-for-sale securities to be included as other comprehensive income in the consolidated balance sheets.

Classifications

Certain amounts for the prior years have been reclassified to conform with the 1999 presentation.

3. Investments

Investments consist of US Treasury securities, obligations of US Government sponsored enterprises, municipal bonds, equity securities and other financial instruments. Upon completion of management's reevaluation of the classification of the investment portfolio at December 31, 1998, a majority of the held-to-maturity investment portfolio was reclassified to available-for-sale in order to align the investment portfolio with management's current intentions. The amortized cost and fair value of the investments transferred amounted to \$126.8 million and \$129.9 million, respectively.

Following is a summary of investments classified as available-for-sale which are carried at fair value as of December 31, 1999:

	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
Due in one year or less	\$ 17,472	\$ 43	\$ -	\$ 17,515
Due after one year through five years	114,288	94	(2,100)	112,282
Equity securities	19,125	5,642	(998)	23,769
	<u>\$ 150,885</u>	<u>\$ 5,779</u>	<u>\$ (3,098)</u>	<u>\$ 153,566</u>

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements
(In thousands, except share amounts)

3. Investments (continued)

Following is a summary of investments classified as held-to-maturity which are carried at amortized cost as of December 31, 1999:

	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
Due in one year or less	\$ 10,697	\$ 7	\$ (178)	\$ 10,526
Due after one year through five years	17,720	-	(439)	17,281
	<u>\$ 28,417</u>	<u>\$ 7</u>	<u>\$ (617)</u>	<u>\$ 27,807</u>

Following is a summary of investments classified as available-for-sale which are carried at fair value as of December 31, 1998:

	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
Due in one year or less	\$ 27,618	\$ 251	-	\$ 27,869
Due after one year through five years	99,155	2,857	-	102,012
	<u>\$ 126,773</u>	<u>\$ 3,108</u>	<u>-</u>	<u>\$ 129,881</u>

Following is a summary of investments classified as held-to-maturity which are carried at amortized cost as of December 31, 1998:

	Amortized Cost	Gross Unrealized		Fair Value
		Gain	Loss	
Due in one year or less	\$ 11,582	\$ 30	-	\$ 11,612
Due after one year through five years	16,588	311	-	16,899
	<u>\$ 28,170</u>	<u>\$ 341</u>	<u>-</u>	<u>\$ 28,511</u>

At December 31, 1999 and 1998, investments with a carrying amount of approximately \$28.0 million were pledged as collateral for Nasdaq's note payable.

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements (In thousands, except share amounts)

4. Fair Value of Financial Instruments

Nasdaq considers cash and cash equivalents, accounts receivable, investments, investments in subsidiaries, accounts payable and accrued expenses, due to banks, and long-term debt to be its financial instruments. The carrying amount reported in the balance sheet for cash and cash equivalents, accounts receivable, investments, accounts payable and accrued expenses, and due to banks closely approximate their fair values. The approximate fair value of Nasdaq's long-term debt was estimated using a discounted cash flow analysis, based on Nasdaq's assumed incremental borrowing rates for similar types of borrowing arrangements. This analysis indicates that the fair value of Nasdaq's long-term debt at December 31, 1999 and 1998 approximates its carrying amount. The fair value of its investments in subsidiaries is not determinable since these investments do not have quoted market prices.

5. Long-Term Debt

In May 1997, the Company entered into a \$25.0 million note payable with a financial institution (the "Lender"). The note requires monthly interest payments at a rate of 7.41 percent through May 2007. In May 2007, Nasdaq will incur interest equal to the Lender's cost of funds rate, as defined in the agreement, plus .5%. Principal payments are scheduled to begin in 2007 and continue in equal monthly installments until maturity in 2012. Interest expensed and paid under the agreement totaled approximately \$1.9 million for the years ended December 31, 1999 and 1998, respectively. Of the \$1.0 million interest incurred and paid in the year ended December 31, 1997, \$0.4 million was capitalized in connections with the expansion of Nasdaq facilities.

6. Income Taxes

The income tax provision includes the following amounts:

	Years ended December 31,		
	1999	1998	1997
Current income taxes:			
Federal	\$ 46,482	\$ 22,930	\$ 24,026
State	11,599	5,196	5,410
Total current income taxes	<u>58,081</u>	<u>28,126</u>	<u>29,436</u>
Deferred income taxes:			
Federal	273	(1,695)	3,005
State	67	(421)	746
Total deferred income taxes	<u>340</u>	<u>(2,116)</u>	<u>3,751</u>
Total provision for income taxes	<u>\$ 58,421</u>	<u>\$ 26,010</u>	<u>\$ 33,187</u>
Income taxes paid during the year	\$ 49,992	\$ 24,131	\$ 29,074

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements
(In thousands, except share amounts)

6. Income Taxes (continued)

Reconciliations of the statutory United States federal income tax rates to the effective tax rates are as follows:

	Years ended December 31,		
	1999	1998	1997
Federal	35.0%	35.0%	35.0%
State	5.2	5.1	5.3
Other, net	.2	2.6	5.0
Effective Rate:	40.4%	42.7%	45.3%

Components of Nasdaq's deferred tax assets and liabilities, which are included as other current assets and other accrued liabilities in the consolidated balance sheets, consisted of the following:

	December 31,	
	1999	1998
Deferred tax assets:		
Deferred fees	\$ 2,233	\$ 1,627
Compensation and benefits	179	1,015
Bad debts	2,801	1,653
Other	5,161	3,845
Total deferred tax assets	10,374	8,140
Deferred tax liabilities:		
Depreciation	(9,966)	(11,262)
SOP 98-1	(5,184)	-
Other	(939)	(1,139)
Total deferred tax liabilities	(16,089)	(12,401)
Net deferred tax liability	\$ (5,715)	\$ (4,261)

7. Pension Benefits

The NASD maintains a noncontributory, defined-benefit pension plan, along with other arrangements, for the benefit of eligible employees of its subsidiaries. The benefits are primarily based on years of service and the employees' average salary during the highest 60 consecutive months of employment.

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements

(In thousands, except share amounts)

7. Pension Benefits (continued)

The following table sets forth the plans' funded status and amounts recognized in the Nasdaq balance sheets of December 31:

	Pension Benefits	
	1999	1998
Change in benefit obligation		
Benefit obligation at beginning of year	\$ 33,184	\$ 26,905
Service cost	3,304	2,817
Interest cost	2,448	2,039
Amendments	-	755
Actuarial losses	3,613	678
Benefits paid	(2,246)	(892)
Curtailment	-	-
(Gain) loss due to change in discount rate	(530)	882
Benefit obligation at end of year	<u>\$ 39,773</u>	<u>\$ 33,184</u>
Change in plan assets		
Fair value of plan assets at beginning of year	\$ 22,801	\$ 18,779
Actual return on plan assets	5,275	2,626
Company contributions	2,480	2,288
Benefits paid	(2,246)	(892)
Fair value of plan assets at end of year	<u>\$ 28,310</u>	<u>\$ 22,801</u>
Funded status of the plan (underfunded)	(11,463)	(10,383)
Unrecognized net actuarial gain	1,445	1,478
Unrecognized prior service cost	977	1,110
Unrecognized transition asset	(447)	(504)
Accrued benefit cost	<u><u>\$ (9,488)</u></u>	<u><u>\$ (8,299)</u></u>

As of December 31, 1999 and 1998, \$2.4 million and \$3.7 million, respectively, of the accrued pension liability is carried as current in the accounts payable and accrued expenses line of the consolidated balance sheets.

	Pension Benefits	
	1999	1998
Weighted-average assumptions as of December 31		
Discount rate	8.0%	7.0%
Expected return on plan assets	9.0	9.0
Rate of compensation increase	5.3	5.3

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements
(In thousands, except share amounts)

7. Pension Benefits (continued)

	Pension Benefits		
	1999	1998	1997
Components of net periodic benefit cost			
Service cost	\$ 3,304	\$ 2,817	\$ 2,151
Interest cost	2,448	2,039	1,717
Expected return on plan assets	(2,261)	(1,693)	(1,412)
Amortization of unrecognized transition asset	(57)	(57)	(57)
Recognized net actuarial loss	101	65	131
Prior service cost recognized	133	131	167
Benefit cost	\$ 3,668	\$ 3,302	\$ 2,697

The NASD also maintains a voluntary savings plan for eligible employees of its subsidiaries. Employees are immediately eligible to make contributions to the plan and after one year of service are also eligible for an employer contribution match at an amount equal to 50.0% of the first 6.0% of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from Nasdaq. Savings plan expense for the years ended December 31, 1999, 1998 and 1997 was \$2.9 million, \$2.0 million, and \$1.8 million, respectively. The expense included a discretionary match authorized by the NASD Board totaling \$1.3 million for the year ended December 31, 1999, \$1.0 million for the year ended December 31, 1998, and \$0.9 million for the year ended December 31, 1997.

8. Leases

Nasdaq leases certain office space and equipment in connection with its operations. The majority of these leases contain escalation clauses based on increases in property taxes and building operating costs. Certain of these leases also contain renewal options. Rent expense for operating leases was \$4.0 million for the year ended December 31, 1999, \$1.4 million for the year ended December 31, 1998 and \$1.7 million for the year ended December 31, 1997. Future minimum lease payments under noncancelable operating leases with initial or remaining terms of one year or more consisted of the following at December 31, 1999:

Year ending December 31:	
2000	\$ 7,397
2001	7,442
2002	7,404
2003	7,445
2004	7,668
Remaining years	50,105
Total minimum lease payments	\$ 87,461

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements

(In thousands, except share amounts)

9. Commitments and Contingencies

In November 1997, Nasdaq entered into an agreement with MCI WorldCom Inc. to replace the existing data network that connects the Nasdaq market facilities to market participants. The contract contains a minimum guarantee of \$300 million to be incurred through November 2003. Billings under the contract are \$67.9 million as of December 31, 1999. Data communication costs incurred under network agreements are directly charged to market participants and, therefore, are netted against these revenues. Management anticipates that the minimum guarantee under the contract will be achieved.

In November 1998, Nasdaq entered into a \$36.8 million agreement for the construction of the Nasdaq MarketSite complex to be located in Times Square, New York. The first stage of the MarketSite, a 10,800 square foot outdoor video screen, began operating on December 28, 1999. Other features to be completed by Spring 2000 include office, conference and retail space, in addition to a public interactive exhibit and a new broadcast facility. During the year ended December 31, 1999, approximately \$31.2 million was incurred on this project.

In September 1998, Nasdaq entered into a partnership with OptiMark Technologies, Inc. ("OptiMark") to design and develop an anonymous order matching system ("OptiMark System") that will be integrated into the Nasdaq network in Trumbull, Connecticut. OptiMark is the creator and owner of the OptiMark System, an electronic trading process that, through the use of powerful supercomputers and patented algorithms, matches buying and selling profiles to achieve best available prices in the marketplace. Pursuant to the operating agreement between Nasdaq and OptiMark, Nasdaq has the obligation to provide the network on which OptiMark transactions will be transmitted, the development required to integrate the OptiMark System with the Nasdaq Workstation II ("NWII"), and the facilities to support the system. Management estimates that through December 31, 1999, approximately \$2.5 million of costs were incurred related to development and maintenance of the OptiMark System. Future costs to be incurred related to maintenance of the system are not expected to be material to Nasdaq's operations.

In April 1999, Nasdaq signed a letter of intent to acquire Financial Systemware, Inc. ("FSI") a company which develops and markets a set of software utilities which can be loaded on a NWII terminal to enhance the features and functionalities of the NWII software. This transaction, which is expected to be completed in the Spring of 2000, will be accounted for under the purchase method. Upon the closing of the transaction, Nasdaq will acquire 100 percent of FSI's issued and outstanding stock for \$5.0 million plus the book value of the net assets as of the closing date. The FSI principals, the sellers, will collectively be paid \$25.0 million over the next five years, of which \$10.0 million will be paid upon closing. Five cash payments of \$3.0 million will be paid over the five years following closing, contingent upon the continued employment and development efforts of the FSI principals.

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements (In thousands, except share amounts)

9. Commitments and Contingencies (continued)

Nasdaq may be subject to claims arising out of the conduct of its business. Currently, there are certain legal proceedings pending against Nasdaq. Management believes, based upon the opinion of counsel, that any liabilities or settlements arising from these proceedings will not have a material effect on the financial position or results of operations of Nasdaq. Management is not aware of any unasserted claims or assessments that would have a material adverse effect on the financial position and the results of operations of Nasdaq.

10. Related Party Transactions

Related party receivables and payables are the result of various transactions between Nasdaq and its affiliates. Payables to related parties are comprised primarily of the regulation charge that NASDR, a wholly owned subsidiary of the NASD, charges Nasdaq for costs incurred related to Nasdaq market regulation and enforcement. Support charges from the NASD to Nasdaq represent another significant component of payable to related parties. The support charge includes an allocation of a portion of the NASD's administrative expenses as well as its costs incurred to develop and maintain technology on behalf of Nasdaq. The remaining component of payables to related parties is cash disbursements funded by the NASD on behalf of Nasdaq.

Receivables from related parties are primarily attributable to costs incurred by Amex and funded by Nasdaq related to various Amex technology projects. The remaining portion of the receivable from related parties balance is related to cash disbursements funded by Nasdaq on behalf of its affiliates. Disbursements made by Nasdaq on behalf of affiliates relate mainly to office supply and utility charges where Nasdaq represents the largest portion.

Surveillance Charge from NASDR

NASDR incurs costs associated with surveillance monitoring, legal and enforcement activities related to the surveillance of Nasdaq. These costs are charged to Nasdaq based upon NASD management's estimated percentage of costs incurred by each NASDR department that are attributable directly to Nasdaq market surveillance. The following table represents Nasdaq management's estimate of the composition of costs charged by NASDR to Nasdaq:

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements
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10. Related Party Transactions (continued)

	Years ended December 31,		
	1999	1998	1997
Compensation	\$32,529	\$29,894	\$25,451
Professional and contract services	20,000	16,193	10,673
Occupancy	1,687	1,945	1,348
Publications, supplies and postage	1,661	1,744	1,504
Computer operations and data communications	3,430	2,503	2,117
Depreciation	3,831	3,205	2,300
Travel, meetings and training	1,841	1,670	1,289
Other	150	192	186
Total	<u>\$65,129</u>	<u>\$57,346</u>	<u>\$44,868</u>

Support Charge from the NASD

The NASD provides various administrative services to Nasdaq including legal assistance, accounting and managerial services. It is the NASD's policy to charge these expenses and other operating costs to Nasdaq based upon usage percentages determined by management of the NASD and Nasdaq. Additionally, the NASD incurs certain costs related to the development and maintenance of technology for Nasdaq. Technology development costs are allocated directly to Nasdaq based upon specific projects requested by Nasdaq. Technology maintenance costs are allocated based upon Nasdaq's share of computer usage. The following table represents Nasdaq management's estimate of the composition of costs charged by the NASD to Nasdaq:

	Years ended December 31,		
	1999	1998	1997
Compensation	\$25,956	\$25,942	\$20,190
Professional and contract services	16,671	7,784	4,490
Occupancy	4,637	5,212	3,473
Publications, supplies and postage	2,295	2,368	2,277
Computer operations and data communications	5,243	4,145	4,308
Depreciation	6,514	5,335	4,466
Travel, meetings and training	2,020	1,551	1,283
Other	759	267	525
Total	<u>\$64,095</u>	<u>\$52,604</u>	<u>\$41,012</u>

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements (In thousands, except share amounts)

10. Related Party Transactions (continued)

Nasdaq Charge to the Amex

Nasdaq incurs technology costs on behalf of Amex related to development of new Amex systems and enhancement of existing Amex systems. Additionally, Nasdaq incurs certain operating costs such as marketing on behalf of Amex. Amounts are charged based upon specific projects requested by Amex. Amounts charged from Nasdaq to Amex are included in support costs from related parties and are summarized as follows:

	Years ended December 31,		
	1999	1998	1997
Compensation	\$ 600	\$1,128	\$-
Professional and contract services	13,090	7,334	-
Publications, supplies and postage	19	35	-
Other	326	612	-
Total	<u>\$14,035</u>	<u>\$9,109</u>	<u>\$-</u>

In the opinion of management, all methods of cost allocation described above are reasonable for the services rendered.

11. Warrants

In connection with the OptiMark partnership, OptiMark agreed to issue to Nasdaq warrants to purchase up to an aggregate of 11.25 million shares of its (\$.01 par value) common stock. The warrants when issued are exercisable in several tranches upon the achievement of certain milestones, which are based primarily upon the average daily share volume of Nasdaq securities traded through the OptiMark Trading System. The first milestone is the warrant commencement date, which occurred on October 11, 1999. On that date, Nasdaq received two fully exercisable warrants from OptiMark to purchase 4.5 million shares. The first 2.25 million shares may be purchased at an exercise price of \$5.00 per share. All remaining warrants provide that shares may be purchased at an exercise price of \$7.00 per share. The warrants are exercisable through the earlier of (i) the last day that the OptiMark System continues to be available on all NWII workstations and (ii) the fifth anniversary of the warrant commencement date, or October 11, 2004. As of October 11, 1999, these warrants had a combined value of \$33.5 million which is considered to be the cost of these warrants. The deferred revenue associated with these warrants will be amortized into income based on share volume traded through the OptiMark System.

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements (In thousands, except share amounts)

12. Reorganization

On January 4, 2000, the NASD Board unanimously approved a plan to broaden the ownership in Nasdaq through a two-phase private placement of (1) newly-issued shares of Common Stock, and (2) Warrants to purchase shares of Common Stock (the "Restructuring"), to key stakeholders such as NASD membership, Nasdaq market participants, Nasdaq issuers, institutional investors and strategic partners. The Restructuring is intended, among other things, to strategically realign the ownership of Nasdaq, minimize potential conflicts of interest between Nasdaq and NASDR and allow Nasdaq to respond to current and future competitive challenges caused by technological advances and the increasing globalization of financial markets.

As part of the Restructuring it is planned that, (i) the NASD will separate Amex from Market Group so that Market Group's sole asset will be; (ii) Market Group will be merged into Nasdaq; and (iii) Nasdaq, the surviving entity, will effect a 50,000-for-one split of its Common Stock, to create 100 million shares of Common Stock outstanding (all of which will be initially owned by the NASD).

In 1999, the NASD and SOFTBANK Corp., a Japanese corporation, entered into an agreement to capitalize a new company, Nasdaq Japan Planning Company, Inc., which will undertake to develop and implement a new electronic sock market in Japan. In August 1999, pursuant to the agreement, the NASD paid \$2.6 million for common stock equating to a 50% interest in the joint venture. As part of the Restructuring, Nasdaq Japan Planning Company, Inc. will be transferred by the NASD to Nasdaq or to Nasdaq Global Holding ("Nasdaq Global") and will be supported by either Nasdaq or Nasdaq Global thereafter.

Management anticipates that the Restructuring, along with the other changes discussed above, will be completed during 2000, pending further approval by, among others, the Securities and Exchange Commission and NASD members.

13. Subsequent Events

In January 2000, the NASD established IndigoMarkets, a joint venture company with SSI Technologies, a division of SSI Ltd., of India. The NASD currently has a 55% interest in the venture. The new company will create Internet-based trading and market systems for Nasdaq global markets, including Nasdaq Japan and Nasdaq Europe. IndigoMarkets is also expected to sell its products to other customers worldwide. It is intended that as part of the Restructuring, IndigoMarkets will be transferred by the NASD to Nasdaq or to Nasdaq Global and will be supported by either Nasdaq or Nasdaq Global thereafter.

In February 2000, the NASD signed a joint venture agreement with SOFTBANK Corp. of Japan, News Corporation's venture capital fund partners and Vivendi of France's venture capital fund Viventures Capital to form Nasdaq Europe. The NASD currently has a 50% interest in the venture and the NASD contemplates that its interest will be reduced in the future. Nasdaq Europe is part of Nasdaq's plan to build a global stock exchange that offers nonstop trading of

The Nasdaq Stock Market, Inc.

Notes to Consolidated Financial Statements (In thousands, except share amounts)

13. Subsequent Events (continued)

securities in all parts of the world. Nasdaq Europe intends to establish an electronic exchange that will list shares of companies based in Europe and intends to utilize an innovative hybrid market model that would combine a next generation central limit order book with the best elements of a multiple dealer-based system. This market model will support trading and promote liquidity in a wide range of securities, including high-growth European equities. Nasdaq Europe is scheduled to begin operating in the fourth quarter of 2000. This schedule is dependent, however, upon implementation of the technological architecture to support the market and necessary regulatory approvals. Further, the highly competitive and fragmented nature of the European marketplace could also impact the beginning of operations in Europe. It is intended that as part of the Restructuring, Nasdaq Europe will be transferred from the NASD to Nasdaq or to Nasdaq Global and will be supported by either Nasdaq or Nasdaq Global thereafter.

Nasdaq intends to form Nasdaq Global to act as a management company charged with the establishment and marketing of Nasdaq's worldwide network. Nasdaq Global, which plans to maintain a branch office in the United Kingdom, will maintain effective control over the Nasdaq brand name and proprietary intellectual property in order to ensure focus and consistency as Nasdaq's global operations develop and expand. It is expected that Nasdaq Global will enhance Nasdaq's ability to secure additional capital and other resources for Nasdaq's global expansion through participation in joint ventures around the world. It is expected that Nasdaq Europe and Nasdaq Japan will become subsidiaries of Nasdaq Global.