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**THE NASDAQ STOCK MARKET, INC.  
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS AND SCHEDULE**

The following consolidated financial statements of The Nasdaq Stock Market, Inc. and its subsidiaries are presented herein on the page indicated:

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**Table of Contents****Report of Independent Registered Public Accounting Firm**

Board of Directors and Stockholders  
The Nasdaq Stock Market, Inc.

We have audited the accompanying consolidated balance sheets of The Nasdaq Stock Market, Inc. and subsidiaries (“Nasdaq” or “the Company”) as of December 31, 2004 and 2003 and the related consolidated statements of income, changes in stockholders’ equity, and cash flows for each of the three years in the period ended December 31, 2004. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These consolidated financial statements and schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audits. We did not audit the consolidated financial statements of Toll Associates LLC, a wholly-owned subsidiary, which reflect 29.7% of consolidated total assets as of December 31, 2004, and less than 1.0% of consolidated gross margin for the year then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for Toll Associates LLC, is based solely on the report of the other auditors.

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

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Nasdaq and subsidiaries at December 31, 2004 and 2003, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2004, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of The Nasdaq Stock Market, Inc.’s internal control over financial reporting as of December 31, 2004, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated March 2, 2005 expressed an unqualified opinion thereon.

*/s/ Ernst & Young & LLP*

New York, NY  
March 2, 2005

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**Table of Contents****Report of Independent Registered Public Accounting Firm**

To the Member of  
Toll Associates LLC

We have audited the accompanying consolidated balance sheet of Toll Associates LLC and subsidiaries (the "Company"), including Brut, LLC, as of December 31, 2004, and the related consolidated statements of operations, cash flows and member's equity for the period September 7, 2004 through December 31, 2004. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2004, and the results of its operations and its cash flows for the period September 7, 2004 through December 31, 2004 in conformity with accounting principles generally accepted in the United States of America.

*/s/ Deloitte & Touche LLP*

February 28, 2005  
New York, New York

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**The Nasdaq Stock Market, Inc.**  
**Consolidated Balance Sheets**  
(in thousands, except share and par value amounts)

	<u>December 31,</u>	
	<u>2004</u>	<u>2003</u>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 58,186	\$ 148,929
Investments:		
Available-for-sale, at fair value	174,913	185,704
Held-to-maturity, at amortized cost	28,600	23,765
Receivables, net	104,258	111,405
Receivables from related parties	3,229	7,731
Deferred tax asset	24,209	40,460
Other current assets	12,802	11,623
<b>Total current assets</b>	<b>406,197</b>	<b>529,617</b>
Investments:		
Held-to-maturity, at amortized cost	2,008	4,506
Property and equipment:		
Land, buildings and improvements	97,322	96,578
Data processing equipment and software	205,279	346,928
Furniture, equipment and leasehold improvements	140,026	168,478
	442,627	611,984
Less accumulated depreciation and amortization	(268,787)	(369,041)
<b>Total property and equipment, net</b>	<b>173,840</b>	<b>242,943</b>
Non-current deferred tax asset	48,765	72,079
Goodwill	141,381	—
Intangible assets, net	40,791	871
Other assets	1,838	1,238
<b>Total assets</b>	<b>\$ 814,820</b>	<b>\$ 851,254</b>
<b>Liabilities</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 40,180	\$ 29,959
Accrued personnel costs	49,383	48,817
Deferred revenue	59,537	59,739
Other accrued liabilities	42,467	75,951
Current obligation under capital lease	—	1,607
Payables to related parties	16,749	21,558
<b>Total current liabilities</b>	<b>208,316</b>	<b>237,631</b>
Senior notes	25,000	25,000
Subordinated notes	240,000	240,000
Accrued pension costs	25,671	26,831
Non-current deferred tax liability	29,514	40,917
Non-current deferred revenue	89,821	84,703
Other liabilities	39,935	35,476
<b>Total liabilities</b>	<b>658,257</b>	<b>690,558</b>
<b>Stockholders' equity</b>		
Common stock, \$.01 par value, 300,000,000 shares authorized, shares issued: 130,653,191 in 2004 and 130,611,221 in 2003; shares outstanding: 78,973,085 in 2004 and 78,483,919 in 2003	1,306	1,306
Preferred stock, 30,000,000 shares authorized, Series C: 1,338,402 shares issued and outstanding in 2004; Series A: 1,338,402 shares issued and outstanding in 2003; Series B: 1 share issued and outstanding in 2004 and 2003	130,134	133,840
Additional paid-in capital	355,943	358,923
Common stock in treasury, at cost: 51,680,106 shares in 2004 and 52,127,302 shares in 2003	(662,002)	(667,765)
Accumulated other comprehensive (loss) income	(1,056)	86
Deferred stock compensation	(1,030)	(1,102)
Common stock issuable	2,567	2,881
Retained earnings	330,701	332,527
<b>Total stockholders' equity</b>	<b>156,563</b>	<b>160,696</b>

Total liabilities and stockholders' equity

\$ 814,820

\$ 851,254

See accompanying notes to consolidated financial statements.

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**The Nasdaq Stock Market, Inc.**  
**Consolidated Statements of Income**  
(in thousands, except per share amounts)

	Year Ended December 31,		
	2004	2003	2002
<b>Revenues</b>			
Market Services	\$334,517	\$ 383,715	\$581,774
Issuer Services	205,821	204,186	203,969
Other	103	1,944	1,411
	<u>540,441</u>	<u>589,845</u>	<u>787,154</u>
<b>Cost of revenues</b>	(55,845)	—	—
	<u>484,596</u>	<u>589,845</u>	<u>787,154</u>
<b>Gross margin</b>			
<b>Expenses</b>			
Compensation and benefits	148,155	159,097	183,130
Marketing and advertising	12,790	19,515	26,931
Depreciation and amortization	76,336	89,983	88,502
Professional and contract services	23,709	37,544	60,499
Computer operations and data communications	98,903	125,618	136,642
Provision for bad debts	1,074	1,365	8,426
Occupancy	28,730	31,212	32,367
General and administrative	41,128	28,411	48,634
	<u>430,825</u>	<u>492,745</u>	<u>585,131</u>
Total direct expenses	430,825	492,745	585,131
Elimination of non-core product lines, initiatives and severance	—	97,910	—
Nasdaq Japan impairment loss	—	(5,000)	15,208
Support costs from related parties, net	45,588	61,504	74,968
	<u>476,413</u>	<u>647,159</u>	<u>675,307</u>
Total expenses	476,413	647,159	675,307
Operating income (loss)	8,183	(57,314)	111,847
Interest income	5,854	9,517	12,583
Interest expense	(11,484)	(18,555)	(18,488)
	<u>2,553</u>	<u>(66,352)</u>	<u>105,942</u>
Operating income (loss) from continuing operations before income taxes	2,553	(66,352)	105,942
(Provision) benefit for income taxes	(749)	21,240	(40,921)
	<u>\$ 1,804</u>	<u>\$ (45,112)</u>	<u>\$ 65,021</u>
<b>Net income (loss) from continuing operations</b>	\$ 1,804	\$ (45,112)	\$ 65,021
Net income (loss) from discontinued operations, net of tax	9,558	(60,335)	(21,893)
	<u>\$ 11,362</u>	<u>\$(105,447)</u>	<u>\$ 43,128</u>
<b>Net income (loss)</b>	\$ 11,362	\$(105,447)	\$ 43,128
<b>Net (loss) income applicable to common stockholders:</b>			
Net income (loss)	\$ 11,362	\$(105,447)	\$ 43,128
Preferred stock:			
Loss on exchange of securities	(3,908)	—	—
Dividends declared	(8,354)	(8,279)	—
Accretion of preferred stock	(926)	—	(9,765)
	<u>\$ (1,826)</u>	<u>\$(113,726)</u>	<u>\$ 33,363</u>
Net (loss) income applicable to common stockholders	\$ (1,826)	\$(113,726)	\$ 33,363

**Basic and diluted net (loss) earnings per share:**

Continuing operations	\$ (0.14)	\$ (0.68)	\$ 0.66
Discontinued operations	0.12	(0.77)	(0.26)
	<u>          </u>	<u>          </u>	<u>          </u>
Total basic and diluted net (loss) earnings per share	\$ (0.02)	\$ (1.45)	\$ 0.40
	<u>          </u>	<u>          </u>	<u>          </u>

See accompanying notes to consolidated financial statements.

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**The Nasdaq Stock Market, Inc.**  
**Consolidated Statements of Changes in Stockholders' Equity**  
**(in thousands, except share amounts)**

	Number of Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Common Stock in Treasury	Preferred Stock Series C and B	Preferred Stock Series A and B	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Deferred Stock Compensation	Common Stock Issuable	Total
Balance, January 1, 2002	111,700,285	\$ 1,302	\$ 348,457	\$(240,000)	\$ —	\$ —	\$ 412,890	\$ (6,976)	\$ (3,350)	6,065	\$ 518,388
Net income	—	—	—	—	—	—	43,128	—	—	—	43,128
Change in unrealized losses on available- for-sale investments, net of tax of \$1,158	—	—	—	—	—	—	—	(2,048)	—	—	(2,048)
Foreign currency translation, net of minority interests of \$100	—	—	—	—	—	—	—	6,402	—	—	6,402
Minimum pension liability, net of tax of \$(192)	—	—	—	—	—	—	—	296	—	—	296
Comprehensive income for the year ended December 31, 2002	—	—	—	—	—	—	—	—	—	—	47,778
Purchase of common stock for treasury	(33,768,895)	—	—	(429,454)	—	—	—	—	—	—	(429,454)
Issuance of preferred stock	—	—	—	—	—	124,075	—	—	—	—	124,075
Accretion of preferred stock dividends	—	—	—	—	—	9,765	(9,765)	—	—	—	—
Capital contribution from NASD, net of distribution to NASD for insurance agency	—	—	5,069	—	—	—	—	—	—	—	5,069
Adjustment of carrying value of Nasdaq Europe due to sale of securities to third party	—	—	728	—	—	—	—	—	—	—	728
Restricted stock awards, net of forfeitures	—	—	—	—	—	—	—	—	(620)	620	—
Amortization and vesting of restricted stock	116,660	1	1,747	—	—	—	—	—	2,050	(1,748)	2,050
Other purchases of common stock by related parties or affiliated entities	218,658	2	2,236	—	—	—	—	—	—	—	2,238
Balance, December 31, 2002	78,266,708	\$ 1,305	\$ 358,237	\$(669,454)	\$ —	\$ 133,840	\$ 446,253	\$ (2,326)	\$ (1,920)	4,937	\$ 270,872
Net (loss)	—	—	—	—	—	—	(105,447)	—	—	—	(105,447)
Change in unrealized losses on available- for-sale investments, net of tax of \$(340)	—	—	—	—	—	—	—	760	—	—	760
Foreign currency translation	—	—	—	—	—	—	—	1,948	—	—	1,948
Minimum pension liability, net of tax of \$191	—	—	—	—	—	—	—	(296)	—	—	(296)
Comprehensive loss for the year ended December 31, 2003	—	—	—	—	—	—	—	—	—	—	(103,035)

Preferred stock dividends declared	—	—	—	—	—	—	(8,279)	—	—	—	(8,279)
Distribution to NASD for insurance agency	—	—	(139)	—	—	—	—	—	—	—	(139)
Restricted stock awards, net of forfeitures	—	—	—	—	—	—	—	—	868	(868)	—
Amortization and vesting of restricted stock	92,300	1	1,187	(148)	—	—	—	—	(50)	(1,188)	(198)
Other purchases of common stock by related parties or affiliated entities	124,911	—	(362)	1,837	—	—	—	—	—	—	1,475
<b>Balance, December 31, 2003</b>	<b>78,483,919</b>	<b>\$ 1,306</b>	<b>\$ 358,923</b>	<b>\$(667,765)</b>	<b>—</b>	<b>\$ 133,840</b>	<b>\$ 332,527</b>	<b>\$ 86</b>	<b>\$(1,102)</b>	<b>\$ 2,881</b>	<b>\$ 160,696</b>
Net income	—	—	—	—	—	—	11,362	—	—	—	11,362
Change in unrealized losses on available-for-sale investments, net of tax of \$599	—	—	—	—	—	—	—	(920)	—	—	(920)
Foreign currency translation	—	—	—	—	—	—	—	232	—	—	232
Minimum pension liability, net of tax of \$293	—	—	—	—	—	—	—	(454)	—	—	(454)
<b>Comprehensive income for the year ended December 31, 2004</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>10,220</b>
Exchange of securities	—	—	—	—	129,208	(133,840)	(3,908)	—	—	—	(8,540)
Accretion of preferred stock	—	—	—	—	926	—	(926)	—	—	—	—
Preferred stock dividends declared	—	—	—	—	—	—	(8,354)	—	—	—	(8,354)
Distribution to NASD for insurance agency	—	—	(290)	—	—	—	—	—	—	—	(290)
Restricted stock awards, net of forfeitures	—	—	—	—	—	—	—	—	(469)	469	—
Amortization and vesting of restricted stock	77,770	—	324	459	—	—	—	—	541	(783)	541
Stock options exercised	310,296	—	(2,303)	3,975	—	—	—	—	—	—	1,672
Other purchases of common stock by related parties or affiliated entities	101,100	—	(711)	1,329	—	—	—	—	—	—	618
<b>Balance at December 31, 2004</b>	<b>78,973,085</b>	<b>\$ 1,306</b>	<b>\$ 355,943</b>	<b>\$(662,002)</b>	<b>\$ 130,134</b>	<b>—</b>	<b>\$ 330,701</b>	<b>\$ (1,056)</b>	<b>\$(1,030)</b>	<b>\$ 2,567</b>	<b>\$ 156,563</b>

See accompanying notes to consolidated financial statements.

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**The Nasdaq Stock Market, Inc.**  
**Consolidated Statements of Cash Flows**  
**(in thousands)**

	Year Ended December 31,		
	2004	2003	2002
<b>Reconciliation of net income (loss) to cash provided by operating activities</b>			
Net income (loss)	\$ 11,362	\$(105,447)	\$ 43,128
Net income (loss) from discontinued operations	9,558	(60,335)	(21,893)
Net income (loss) from continuing operations	\$ 1,804	\$ (45,112)	\$ 65,021
Non-cash items included in net income (loss):			
Depreciation and amortization	76,336	89,983	88,502
Amortization of restricted stock awards	541	(50)	3,155
Provision for bad debts	1,074	1,365	8,426
Loss on assets held-for-sale	7,369	—	—
Loss from equity method affiliates	—	4,101	12,114
Elimination of non-core product lines and initiatives	—	33,923	—
Nasdaq Japan impairment loss	—	(5,000)	15,208
Deferred taxes	26,970	2,103	13,662
Other non-cash items included in net income	7,618	13,050	8,201
Net change in:			
Receivables, net	26,360	44,500	27,864
Receivables from related parties	5,104	2,513	17,662
Other current assets	(3,400)	4,886	(6,989)
Other assets	(884)	9,177	(2,288)
Accounts payable and accrued expenses	(2,132)	(31,672)	(35,902)
Accrued personnel costs	(1,323)	2,216	534
Deferred revenue	4,916	(22,256)	(20,355)
Other accrued liabilities	(30,627)	40,849	(9,505)
Obligation under capital leases	(1,607)	(7,815)	(3,275)
Payables to related parties	(13,951)	(5,766)	17,768
Accrued pension costs	(1,160)	3,273	(1,425)
Other liabilities	4,459	11,553	(15,181)
<b>Cash provided by continuing operations</b>	<b>107,467</b>	<b>145,821</b>	<b>183,197</b>
Cash provided by (used in) discontinued operations	9,558	(40,554)	(28,555)
<b>Cash provided by operating activities</b>	<b>117,025</b>	<b>105,267</b>	<b>154,642</b>
<b>Cash flow from investing activities</b>			
Proceeds from redemptions of available-for-sale investments	240,881	212,725	209,181
Purchases of available-for-sale investments	(235,233)	(179,151)	(212,643)
Proceeds from maturities of held-to-maturity investments	26,828	18,600	—
Purchases of held-to-maturity investments	(29,058)	(18,453)	—
Acquisition of Toll Associates LLC	(190,000)	—	—
Capital contribution to Nasdaq LIFFE joint venture	—	(2,500)	(16,000)
Purchases of property and equipment	(26,029)	(31,595)	(75,153)
Proceeds from sales of property and equipment	11,299	143	8,135
<b>Cash used in investing activities</b>	<b>(201,312)</b>	<b>(231)</b>	<b>(86,480)</b>
<b>Cash flow from financing activities</b>			
Payments for treasury stock purchases	(85)	(148)	(305,155)
(Decrease) increase in long-term debt	—	(150,000)	150,000
Issuances of common stock	2,273	996	2,238
Preferred stock dividends	(8,354)	(8,279)	—
Contribution (to) from NASD	(290)	(139)	5,069
<b>Cash used in financing activities</b>	<b>(6,456)</b>	<b>(157,570)</b>	<b>(147,848)</b>
Decrease in cash and cash equivalents	(90,743)	(52,534)	(79,686)
Cash and cash equivalents at beginning of year	148,929	201,463	281,149
Cash and cash equivalents at end of year	\$ 58,186	\$ 148,929	\$ 201,463
<b>Supplemental Disclosure of Non-Cash Flow Activities</b>			
Cash paid for (received):			
Interest	\$ 11,483	\$ 15,851	\$ 19,276
Income taxes, net of refund	\$ (49,986)	\$ (25,936)	\$ 77,187

Exchange of preferred securities	\$ (8,540)	\$ —	\$ —
Payments for treasury stock purchases with issuance of preferred stock	\$ —	\$ —	\$ 124,075

See accompanying notes to consolidated financial statements.

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements****1. Organization and Nature of Operations**

Nasdaq is a leading provider of securities listings, trading and information products and services. Nasdaq operates The Nasdaq Stock Market, the largest stock-based equity securities market in the United States, both in terms of number of listed companies and traded share volume. Nasdaq is a majority owned subsidiary of NASD. At December 31, 2004, NASD owned approximately 54.7% of Nasdaq including unexpired outstanding warrants to purchase Nasdaq's common stock. At February 15, 2005, NASD's ownership decreased to 33.7% as a result of the public offering sale. See Note 23, "Subsequent Events" for further discussion.

Nasdaq is the parent company of Nasdaq Global Holdings ("Nasdaq Global"); Nasdaq Financial Products Services, Inc. ("Nasdaq Financial Products"); Nasdaq International Market Initiatives, Inc. ("NIMI"); Nasdaq Europe Planning Company, Limited ("Nasdaq Europe Planning"); Nasdaq International, Ltd. ("Nasdaq International"); Nasdaq Canada, Inc. ("Nasdaq Canada"); Nasdaq Technology Services, LLC ("Nasdaq Technology"); and as of September 7, 2004, Toll Associates LLC ("Toll"), collectively referred to as "Nasdaq." These entities are wholly-owned by Nasdaq. Nasdaq Global, which is incorporated in Switzerland and served as a holding company for several corporations incorporated internationally, was completely liquidated in 2004 and subsequently dissolved in 2005. Nasdaq also has determined to dissolve or otherwise wind-down Nasdaq Europe Planning, which was formed to expand Nasdaq into the European community and is currently inactive. NIMI is an entity that employed Nasdaq's expatriates assigned to Nasdaq's international subsidiaries. Nasdaq International is a London-based marketing company. Nasdaq Financial Products is the sponsor of the Nasdaq-100 Trust. Nasdaq Financial Product Services (Ireland) Limited ("Nasdaq Ireland") is a wholly-owned subsidiary of Nasdaq Financial Products. In January 2005, Nasdaq Financial Products changed its name to Nasdaq Global Funds, Inc. Nasdaq Ireland is the manager of The Nasdaq ETF Funds plc. Nasdaq Canada is an extension of Nasdaq's North American trading platform within Canada, which has received regulatory approval to provide trading access in two provinces, Quebec and British Columbia. Nasdaq Technology is a company established in 2004 to provide software, hosting and disaster recovery services.

On September 7, 2004, Nasdaq completed its acquisition of Toll and affiliated entities from SunGard Data Systems Inc. ("SunGard"). Toll is a holding company that owns a 99.8% interest in Brut, LLC ("Brut"), the owner and operator of the Brut ECN, a broker-dealer registered pursuant to the Securities Exchange Act of 1934. Toll also has a 100.0% interest in Brut Inc. ("Brut Inc."), which owns the remaining 0.2% interest in Brut and serves as its manager pursuant to an operating agreement. Brut also owns Brut Europe Limited ("Brut Europe"), a wholly-owned subsidiary set up to generate a European subscriber base, which is currently inactive. See "Acquisition of Brut," of Note 3, "Significant Transactions," and Note 4, "Acquisition of Brut," for further discussion.

On October 31, 2003, Quadsan Enterprises, Inc. ("Quadsan"), previously a wholly-owned subsidiary of Nasdaq that provided investment management services to Nasdaq, was merged with and into Nasdaq. Prior to December 18, 2003, Nasdaq owned a 63.0% interest in Nasdaq Europe, which had previously operated an equity market licensed in Brussels, Belgium. On December 18, 2003, Nasdaq transferred its interest in Nasdaq Europe to a third party. Also, on September 30, 2003, Nasdaq Global sold its 55.5% interest in IndigoMarkets to its partner SSI Limited. See "Strategic Review," of Note 3, "Significant Transactions," for further discussion.

**2. Summary of Significant Accounting Policies****Principles of Consolidation**

The consolidated financial statements include the accounts of Nasdaq and wholly-owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. All non-majority owned investments are accounted for under the equity method of accounting.

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements—(Continued)****Financial Statement Preparation**

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts and the disclosure of contingent amounts in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Certain prior year amounts have been reclassified to conform to the current year presentation.

**Segments**

Nasdaq manages, operates and provides its products and services in two business segments, our Market Services Segment and our Issuer Services Segment. Prior to 2003, Nasdaq operated in one segment. See Note 18, "Segments" for further discussion.

**Cash and Cash Equivalents**

Cash and cash equivalents include cash in banks and all non-restricted highly liquid investments with original maturities of three months or less at the time of purchase. Such equivalent investments included in cash and cash equivalents in the Consolidated Balance Sheets were \$52.9 million and \$138.8 million at December 31, 2004 and 2003, respectively. Cash equivalents are carried at cost plus accrued interest, which approximates fair value due to the short maturities of these instruments.

**Investments**

Under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," ("SFAS 115") management determines the appropriate classification of investments at the time of purchase. Investments for which Nasdaq does not have both 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 stockholders' equity. Fair value is determined based on quoted market prices when available, or if quoted market prices are not available, on discounted expected cash flows using market rates commensurate, with the credit quality and maturity of the investment. Investments for which Nasdaq 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, which are included in interest income in the Consolidated Statements of Income. Realized gains and losses on sales of securities are included in earnings using the specific identification method.

Nasdaq regularly monitors and evaluates the realizable value of its securities portfolio. When assessing securities for other-than-temporary declines in value, Nasdaq considers such factors as, among other things, the duration to which the market value had been less than cost, the performance of the investee's stock price in relation to the stock price of its competitors within the industry and the market in general, any news that has been released specific to the investee and the outlook for the overall industry in which the investee operates. Nasdaq also reviews the financial statements of the investee to determine if the investee is experiencing financial difficulties. If events and circumstances indicate that a decline in the value of these assets has occurred and is deemed to be other-than-temporary, the carrying value of the security is reduced to its fair value and the impairment is charged to earnings. As of December 31, 2003, Nasdaq liquidated all equity securities.

**Receivables, net**

Nasdaq's receivables are concentrated with NASD member firms, market data vendors and Nasdaq-listed companies. Receivables are shown net of reserves for uncollectible accounts. Reserves are calculated based on

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**Table of Contents****The Nasdaq Stock Market, Inc.****Notes to Consolidated Financial Statements—(Continued)**

the age and source of the underlying receivable and are tied to past collections experience. The reserve for bad debts is maintained at a level that management believes to be sufficient to absorb estimated losses in the accounts receivable portfolio. The reserve is increased by the provision for bad debts which is charged against operating results and decreased by the amount of charge-offs, net of recoveries. The amount charged against operating results is based on several factors, including a continuous assessment of the collectibility of each account. In circumstances where a specific customer's inability to meet its financial obligations is known (i.e., bankruptcy filings), Nasdaq records a specific provision for bad debts against amounts due to reduce the receivable to the amount Nasdaq reasonably believes will be collected. For all other customers, provisions for bad debts are made based on the length of time the receivable is past due and historical experience. For receivables past due 31-60 days, 61-90 days and over 90 days, the outstanding account balances are reserved for at 10.0%, 50.0% and 100.0% of the outstanding account balances, respectively. If circumstances change (i.e., higher than expected defaults or an unexpected material adverse change in a major customer's ability to pay), Nasdaq's estimates of recoverability could be reduced by a material amount. Total reserves netted against receivables in the Consolidated Balance Sheets were \$3.2 million and \$1.7 million at December 31, 2004 and 2003, respectively.

**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 from NASD. NASD charges Nasdaq for costs incurred related to Nasdaq market regulation and enforcement. Receivables from related parties relates to cash disbursements and loans funded by us on behalf of Nasdaq's affiliates.

**Deposits**

Other current assets include \$2.0 million of deposits at December 31, 2004. These deposits are for Brut and serve primarily for clearance and settlement services. Brut is required to hold a minimum clearing deposit with Merrill Lynch Professional Clearing Services and the NSCC. In addition, the NSCC requires a daily minimum requirement which is based upon the previous days trading activity in Brut.

**Property and Equipment, net**

Property and equipment including leasehold improvements, are carried at cost less accumulated depreciation and amortization. Land is recorded at cost. 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 generally recognized over the estimated useful lives of the related assets. Estimated useful lives generally range from 10 to 40 years for buildings and improvements, two to five years for data processing equipment and software and five to 10 years for furniture and equipment. Leasehold improvements are amortized over the shorter of their estimated useful lives or the remaining term of the related lease. Depreciation and amortization are computed by the straight-line method. Depreciation and amortization expense for property and equipment was \$71.3 million, \$81.9 million and \$82.4 million for the years ended December 31, 2004, 2003 and 2002, respectively and are included in depreciation and amortization expense in the Consolidated Statements of Income.

Property and equipment, net includes a capital lease of \$6.4 million and accumulated amortization of \$4.8 million at December 31, 2003. Nasdaq's capital lease expired in February 2004.

Property and equipment, net also includes an asset held-for-sale with a carrying value of \$17.6 million as of December 31, 2004, related to an owned facility that is being actively marketed. See Note 7, "Real Estate Developments," for further discussion.

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements—(Continued)****Goodwill**

Goodwill represents the excess of purchase price and related costs over the value assigned to the net tangible and identifiable intangible assets of a business acquired. Effective January 1, 2002, as a result of the adoption of SFAS 142, "Goodwill and Other Intangible Assets" ("SFAS 142") Nasdaq no longer amortizes goodwill. Goodwill is subject to annual impairment tests (during the fourth quarter) whereby goodwill is allocated to Nasdaq's reporting units (Market Services and Issuer Services) and an impairment is deemed to exist if the carrying value of a reporting unit exceeds its estimated fair value. For any business dispositions, goodwill is allocated to the business disposed of based on the ratio of the fair value of the business disposed of to the fair value of the reporting unit.

**Intangible Assets, net**

Intangible assets, net which primarily include a technology software license and customer relationships are amortized on a straight-line basis over their estimated average useful life of 10 years. Upon the adoption of SFAS 142, intangible assets deemed to have indefinite useful lives are not amortized and are subject to annual impairment tests. An impairment exists if the carrying value of the indefinite-lived intangible asset exceeds its fair value. For intangible assets subject to amortization, an impairment is recognized if the carrying amount is not recoverable and the carrying amount exceeds the fair value of the intangible asset.

**Valuation of Long-Lived Assets**

Nasdaq assesses potential impairments to its long-lived assets when there is evidence that events or changes in circumstances indicate that the carrying amount of an asset may not be recovered. An impairment loss is recognized when the carrying amount of the long-lived asset is not recoverable and exceeds its fair value. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset. Any required impairment loss is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value and is recorded as a reduction in the carrying value of the related asset and a charge to operating results.

Nasdaq recorded write-downs for property and equipment of \$7.4 million related to long-lived assets held-for-sale in the fourth quarter of 2004. This charge is included in general and administrative expense in the Consolidated Statements of Income. See Note 7, "Real Estate Developments," for further discussion.

During the fourth quarter of 2003, Nasdaq recognized a \$12.3 million impairment charge on the video wall portion of the MarketSite Tower at its Times Square, New York location, based on a significant adverse change in the extent and manner in which the Tower portion of the MarketSite was used. In earlier years, the Tower portion of the MarketSite generated revenues from advertising. However, in the economic downturn that followed September 11<sup>th</sup> and the fall in the technology sector, the revenues from the Tower began to decline steeply and the Tower operated at a significant net loss. Nasdaq's new executive management team was put in place in May 2003 and tried to find alternatives and other strategic uses for the video wall on the MarketSite Tower. However, in the fourth quarter of 2003, it was determined that the Tower would never generate the originally forecasted amounts as the modules that make up the sign are considered outdated and the Tower faces competition from newer advertising technology. Nasdaq obtained a quoted market price valuation from an independent third party and recognized the excess of the carrying amount over the fair value as an impairment charge. The impairment charge was included in the elimination of non-core product lines, initiatives and severance in the Consolidated Statements of Income.

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements—(Continued)****Revenue Recognition and Cost of Revenues**

Market Services revenues are derived from Nasdaq Market Center and Nasdaq Market Services Subscriptions revenues. Nasdaq Market Center revenues are variable, based on service volumes, and recognized as transactions occur. Nasdaq Market Services Subscriptions revenues are based on the number of presentation devices in service and quotes delivered through those devices. Nasdaq Market Services Subscriptions revenues are recognized in the month that information is provided. These revenues are recorded net of amounts due under revenue sharing arrangements with market participants. Pursuant to EITF 99-19 execution revenues from transactions executed through Brut are recorded on a gross basis in revenues and expenses such as liquidity rebate payments are recorded in cost of revenues as Brut acts as principal. Nasdaq's other execution revenues will continue to be reported net of the liquidity rebate as Nasdaq does not act as principal.

Issuer Services revenues include Corporate Client Group revenues and Nasdaq Financial Products revenues. Corporate Client Group revenues include annual fees, initial listing fees and listing of additional shares fees. Annual fees are recognized ratably over the following 12-month period. Initial listing and listing of additional shares fees are recognized on a straight-line basis over estimated service periods, which are six and four years, respectively, based on our historical listing experience. For Nasdaq Financial Products' revenues, Nasdaq receives license fees for its trademark licenses related to the QQQ and other financial products linked to Nasdaq indices issued in the United States and abroad. These revenues are recognized as earned.

**Stock Compensation**

Nasdaq accounts for stock option grants in accordance with APB 25. Nasdaq grants stock options with an exercise price equal to the fair market value of the stock at the date of the grant, and accordingly, recognizes no compensation expense related to such grants.

In the first quarter of 2003, Nasdaq adopted the disclosure requirements of SFAS No. 148 "Accounting for Stock-Based Compensation—Transition and Disclosure" ("SFAS 148"). SFAS 148 amends the disclosure requirements of SFAS 123. Pro forma disclosures of net income and earnings per share as if the fair value method had been applied in measuring compensation expense are provided in Note 15, "Stock Compensation and Stock Awards."

In December 2004, the FASB issued SFAS 123(R), which is a revision of SFAS 123. SFAS 123(R) supersedes APB 25 and amends SFAS No. 95, "Statement of Cash Flows." See Future Accounting Requirements in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Deferred Revenue**

Deferred revenue represents cash received and billed receivables for the Corporate Client Group, which are unearned until services are provided. See Note 6, "Deferred Revenue," for further discussion.

**Advertising Costs**

Nasdaq expenses advertising costs, which include media advertising and production costs, in the periods in which the costs are incurred. Media advertising and production costs included as marketing and advertising expense in the Consolidated Statements of Income totaled \$6.3 million, \$9.7 million and \$13.4 million for the years ended December 31, 2004, 2003 and 2002, respectively.

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

**Software Costs**

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

The provisions of SOP 98-1 require certain costs incurred in connection with developing or obtaining internal use software to be capitalized. Unamortized capitalized software development costs of \$53.7 million and \$61.5 million as of December 31, 2004 and 2003, respectively, are carried in data processing equipment and software in the Consolidated Balance Sheets. Amortization of costs capitalized under SOP 98-1 totaled \$18.9 million, \$15.9 million and \$13.4 million for 2004, 2003 and 2002, respectively, and are included in depreciation and amortization expense in the Consolidated Statements of Income. Additions to capitalized software were \$11.1 million and \$6.3 million in 2004 and 2003, respectively.

SFAS No. 34, "Capitalization of Interest Cost" ("SFAS 34"), requires the capitalization of interest as part of the historical cost of acquiring assets, for all costs incurred to get the assets ready for their internal use. SOP 98-1 includes interest costs incurred while developing internal-use software as capitalizable costs under SFAS 34. As the effect of capitalization of interest cost related to the development of internal-use software is not material when compared with the effect of expensing these interest costs as incurred, all interest costs have been expensed. Amounts expensed were also considered immaterial.

**Income Taxes**

Nasdaq and its eligible subsidiaries file a consolidated U.S. federal income tax return and all applicable state and local returns. Nasdaq uses the asset and liability method required by SFAS No. 109, "Accounting for Income Taxes", to provide income taxes on all transactions recorded in the consolidated financial statements. 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 are realized. If necessary, a valuation allowance is established to reduce deferred tax assets to the amount that is more likely than not to be realized.

**Foreign Currency Translation**

Assets and liabilities of non-U.S. subsidiaries that operate in a local currency environment are translated to U.S. dollars at exchange rates in effect at the balance sheet date. Revenues and expenses are translated at average exchange rates during the year. Translation adjustments resulting from this process are charged or credited to other comprehensive (loss) income.

**3. Significant Transactions***2004 Cost Reductions*

During 2004, in connection with taking certain actions to improve its operational efficiency, Nasdaq incurred expenses of approximately \$62.6 million. The following table summarizes the cost reduction charges included in the Consolidated Statements of Income:

	Year Ended December 31, 2004
	(in millions)
Real estate consolidation	\$ 29.0
Reductions in force	9.4
Technology migration	24.2
Total cost reduction charges	\$ 62.6

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements—(Continued)***Real Estate Consolidation*

During 2004, Nasdaq's management re-evaluated all of Nasdaq's owned and leased real estate and determined that Nasdaq could consolidate staff into fewer locations and save significant costs. In 2004, Nasdaq recorded real estate charges, primarily for sublease loss reserves, of \$29.0 million (net of a \$1.9 million reversal of a sublease reserve recorded in 2003), which is included in general and administrative expense in the Consolidated Statements of Income. In 2003, Nasdaq also recorded real estate charges of \$3.5 million. See Note 7, "Real Estate Developments," for further discussion.

*Reductions in Force*

During the year ended December 31, 2004, 172 positions were eliminated associated with staff reduction plans and Nasdaq recorded a charge of \$9.4 million for severance and outplacement costs, which is included in compensation and benefits expense in the Consolidated Statements of Income. Nasdaq paid approximately \$4.9 million during the year ended December 31, 2004 for these severance and outplacement costs from the 2004 staff reduction plans. Nasdaq expects to pay the remainder of the severance and outplacement costs by the end of the first quarter of 2006. Total headcount decreased from 956 employees at December 31, 2003 to 786 employees at December 31, 2004.

*Technology Migration*

As a result of a continued review of its technology infrastructure, Nasdaq shortened the estimated useful life of certain assets and changed the lease terms on certain operating leases associated with its quoting platform and its trading and quoting network as it migrates to lower cost operating environments which resulted in incremental depreciation and amortization expense. The incremental depreciation and amortization expense associated with these assets and operating leases was \$18.7 million for the year ended December 31, 2004.

In November 2004, Nasdaq purchased a technology platform held-for-sale and owned by Easdaq, for €1.9 million (\$2.4 million). Additionally, in order to make use of the purchased technology platform, Nasdaq purchased a license for the use of certain software for \$0.5 million. Nasdaq has a multi-year initiative to migrate the Nasdaq Market Center applications to lower cost operating environments and processes. The purchased platform will provide a baseline of functionality for the Nasdaq Market Center. The migration will reduce Nasdaq's overall costs. As a result of the migration initiative, Nasdaq shortened the estimated useful life of its current application platform. Beginning in the fourth quarter of 2004, Nasdaq recorded incremental amortization expense of \$2.9 million. Nasdaq expects to record an additional \$19.8 million of incremental amortization expense through March 2007.

In October 2004, Nasdaq entered into an agreement for technology equipment and also renegotiated related operating leases with a major vendor. Nasdaq sold equipment with a net book value of \$13.6 million and entered into a three year lease agreement which included new upgraded equipment. Nasdaq received \$11.0 million in cash from the vendor and recognized a \$2.6 million loss on this transaction, which is included in general and administrative expense in the Consolidated Statements of Income. Nasdaq paid \$1.6 million in 2004 and will pay \$8.2 million, \$0.4 million and \$0.4 million in 2005, 2006 and 2007, respectively, under the terms of the lease agreement. Nasdaq also upgraded related leased equipment and entered into a new three year operating lease and extended the terms of license and maintenance agreements. Under the terms of the operating lease and license and maintenance agreements, Nasdaq paid \$11.2 million in 2004 and will pay \$15.3 million, \$9.0 million and \$2.9 million in 2005, 2006 and 2007, respectively.

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements—(Continued)*****Acquisition of Brut***

On September 7, 2004, Nasdaq announced the completion of its acquisition of Brut, the owner of the Brut ECN and affiliated entities, from SunGard for a total consideration of \$190.0 million in cash, subject to certain post-closing adjustments. See Note 1, "Organization and Nature of Operations" for further discussion of the entities acquired. Nasdaq financed the purchase from available cash and investments. As a result of this acquisition, Nasdaq expects that its customers will benefit from enhanced execution quality, additional quote information and a deeper pool of liquidity in Nasdaq-listed securities and securities listed on other exchanges. Nasdaq's customers also benefit from the ability to access liquidity from multiple destinations outside the Nasdaq Market Center through the use of Brut's sophisticated order routing technology. See Note 4, "Acquisition of Brut," for further discussion.

In connection with the transaction, Brut and SunGard entered into a hosting and multi-year processing agreement for SunGard to provide real-time securities clearance and settlement system for certain Nasdaq trades. Brut also contracted with SunGard to host certain software on designated equipment at a SunGard facility for a transitional period. See Note 19, "Commitments and Contingencies," for further discussion.

***Preferred Stock***

In March 2002, Nasdaq issued 1,338,402 shares of Series A Cumulative Preferred Stock and one share of Series B Preferred Stock. NASD owned all of the outstanding shares of Series A Cumulative Preferred Stock and Series B Preferred Stock. The Series A Cumulative Preferred Stock carried a 7.6% dividend rate for the year commencing March 2003 and carried a 10.6% dividend rate in all subsequent years. The Series B Preferred Stock does not pay dividends. On September 30, 2004, NASD waived a portion of the dividend for the third quarter of 2004 of \$2.5 million and accepted an aggregate amount of \$1.0 million (calculated based on an annual rate of 3.0%) as payment in full of the dividend for this period. On November 29, 2004, Nasdaq entered into an exchange agreement with NASD pursuant to which NASD exchanged 1,338,402 shares of Nasdaq's Series A Cumulative Preferred Stock, representing all the outstanding shares of Series A Cumulative Preferred Stock, for 1,338,402 shares of newly issued Series C Cumulative Preferred Stock. The Series C Cumulative Preferred Stock accrues quarterly dividends at an annual rate of 3.0% for all periods until July 1, 2006 and at an annual rate of 10.6% for periods thereafter. NASD also may be entitled to an additional payment in certain circumstances which may not exceed approximately \$16.3 million in aggregate depending on the amount of time the Series C Cumulative Preferred Stock is outstanding and the market price of Nasdaq's common stock at the time Nasdaq redeems the Series C Cumulative Preferred Stock. See Note 21, "Capital Stock," for further discussion.

Nasdaq recognized a loss of \$3.9 million on the exchange of the preferred securities in retained earnings in the fourth quarter of 2004. This loss was due to the difference between the combined fair market value of the Series C Cumulative Preferred Stock and additional dividend (\$137.7 million) versus the redemption value (\$133.8 million). The value of the additional payment is reflected on the Consolidated Balance Sheet at its estimated fair market value of \$8.5 million. Changes in this account balance are reflected in income in the period of change. The principal amount of the Series C Cumulative Preferred Stock will accrete through retained earnings from its estimated current fair market value of \$129.2 million on November 29, 2004 to its redemption value of \$133.8 million over the five consecutive quarters beginning with the fourth quarter of 2004.

***Strategic Review***

During the second quarter of 2003, Nasdaq announced the results of a strategic review of its operations designed to position Nasdaq for improved profitability and growth. This strategic review included the elimination of non-core product lines and initiatives and resulted in a reduction in Nasdaq's workforce. For the year ended December 31, 2003, a total pre-tax charge to earnings of \$145.5 million was recorded. The net impact to Nasdaq was a total pre-tax charge of \$143.5 million. The difference represented costs absorbed by minority shareholders

Table of Contents**The Nasdaq Stock Market, Inc.****Notes to Consolidated Financial Statements—(Continued)**

of Nasdaq Europe. The charge recorded reflects the completion of the costs associated with Nasdaq's strategic review. As shown in the following table, the total charge of \$145.5 million includes \$97.9 million from continuing operations and \$47.6 million from discontinued operations related to Nasdaq Europe and IndigoMarkets. See Note 5, "Discontinued Operations," for further discussion. The charge was primarily recorded to property and equipment, goodwill, intangible assets, net, other accrued liabilities and accrued personnel costs in the Consolidated Balance Sheets.

The following table summarizes the strategic review charges included in the Consolidated Statements of Income:

	<b>Year Ended December 31, 2003</b>
	<b>(in millions)</b>
<b>Continuing Operations</b>	
<i>Non-Core Product Lines and Initiatives:</i>	
Impairment of capitalized software and fixed assets	\$ 21.1
Impairment of goodwill and intangible assets	8.2
Contract cancellations	11.4
Other exit costs	11.6
	<hr/>
Total non-core product lines and initiatives	52.3
	<hr/>
Severance and benefit costs	32.4
Loss on early extinguishment of debt	13.2
	<hr/>
Total continuing operations strategic review charge	\$ 97.9
	<hr/>
<b>Discontinued Operations</b>	
<i>Nasdaq Europe:</i>	
Impairment of technology platform	\$ 29.4
Severance and benefit costs	2.5
Impairment of goodwill	8.1
Other exit costs including contract cancellations	8.2
	<hr/>
Total Nasdaq Europe	48.2
Gain on disposition of IndigoMarkets	(0.6)
	<hr/>
Total discontinued operations strategic review charge	\$ 47.6
	<hr/>
Total strategic review charge	\$ 145.5
	<hr/>

**Continuing Operations**

Non-core product lines and initiatives included in the strategic review were:

- *Primex*—Primex was an electronic auction system. Nasdaq ended its exclusive rights agreement with Primex Trading N.A., L.L.C. on December 31, 2003. Nasdaq decided to consolidate our trading services to a common functionality within the SuperMontage system and ceased offering Primex effective January 16, 2004.
- *Nasdaq Tools*—Nasdaq Tools was an order management system that ran on the Nasdaq Application Programming Interface using the Nasdaq Workstation II and was wound-down throughout 2003. Nasdaq Tools was a previously wholly-owned subsidiary of Nasdaq and was merged with and into Nasdaq on July 31, 2002.
- *NQLX*—NQLX was a joint venture with LIFFE to create a market for single stock futures and other futures products. On July 24, 2003, Nasdaq redeemed its interest in the NQLX joint venture and

**Table of Contents****The Nasdaq Stock Market, Inc.****Notes to Consolidated Financial Statements—(Continued)**

transferred its ownership interest to LIFFE. LIFFE assumed financial and management responsibility for NQLX. This change did not have any impact on the operation of NQLX, but usage of the Nasdaq brand by the company ceased.

- *BBX*—BBX was a proposed platform for companies not eligible for The Nasdaq SmallCap Market to raise equity capital and increase the visibility of their stock. OTC Bulletin Board continues its existing operations.
- *Liquidity Tracker*—Liquidity Tracker was an automated order routing system designed to allow traders to direct orders to specific market makers based on recent trading activity. Liquidity Tracker ceased operations as of June 30, 2003.
- *MarketSite Tower*—MarketSite Tower is located at Nasdaq's Times Square, New York location. The video wall portion of the Tower was deemed impaired.

The charge related to the elimination of the above non-core products and initiatives was approximately \$52.3 million for the year ended December 31, 2003. Included in the charge was the reduction of Nasdaq's investment in NQLX of \$6.3 million due to the redemption of Nasdaq's interest in the NQLX joint venture, the impairment of goodwill of \$4.1 million associated with Nasdaq Tools, the impairment of certain intangible assets of \$4.1 million, impairment of various capitalized software and fixed assets of \$21.1 million, contract cancellations of \$11.4 million and other costs of \$5.3 million. Included in the \$21.1 million impairment of various capitalized software and fixed assets is a \$12.3 million impairment on the MarketSite Tower. See "Valuation of Long-Lived Assets," of Note 2, "Summary of Significant Accounting Policies," for further discussion. The remaining impairment of capitalized software and fixed assets relates to the eliminated products specifically Nasdaq Tools, Primex, BBX and Liquidity Tracker.

In addition, the charges from continuing operations recorded included severance costs of \$32.4 million and the loss on early extinguishment of long-term debt of \$13.2 million. The severance costs included \$13.8 million related to the reductions in force of 329 employees. The remaining \$18.6 million of severance costs relate to the fulfillment of employment contracts and obligations associated with the retirement and departure of certain members of senior management. Total headcount was 956 as of December 31, 2003 versus 1,227 (excluding 48 employees in discontinued operations) as of December 31, 2002. The extinguishment of debt costs relate to the redemption of \$150.0 million in aggregate principal amount of Nasdaq's 5.83% senior notes due 2007. In conjunction with its strategic review, Nasdaq reassessed its capital needs and determined that it no longer needed the liquidity of the senior notes. See Long-term debt section below for further discussion.

The following table summarizes the strategic review accrual activity from December 31, 2003 through December 31, 2004. These accruals are recorded in other accrued liabilities and accrued personnel costs in the Current liabilities section and in other liabilities in the Non-current liabilities section of the Consolidated Balance Sheets. Nasdaq funded the majority of these reserves, except for a \$4.6 million contract payment that is due January 2006 and other contractual sublease obligations that will continue through 2010.

	<u>Severance for U.S. Employees</u>	<u>Products &amp; Other</u>	<u>Total</u>
	(in millions)		
Accrued liabilities associated with the strategic review as of December 31, 2003	\$ 16.4	\$ 10.7	\$ 27.1
Cash payments	(9.2)	(9.6)	(18.8)
Other	(1.8)	(0.2)	(2.0)
	<u>          </u>	<u>          </u>	<u>          </u>
Accrued liabilities associated with the strategic review as of December 31, 2004	<u>\$ 5.4</u>	<u>\$ 0.9</u>	<u>\$ 6.3</u>

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements—(Continued)****Discontinued Operations**

Discontinued operations included in the strategic review were:

- *Nasdaq Europe*—Nasdaq Europe was a pan-European stock market licensed in Belgium. See below for complete discussion of the wind-down and eventual transfer of shares of Nasdaq Europe.
- *IndigoMarkets*—IndigoMarkets was a joint venture with SSI Limited to develop international trading platforms. On September 30, 2003, Nasdaq Global sold its interest in the joint venture to SSI Limited and recognized a gain on the sale of approximately \$0.6 million.

**Europe**

As a result of the strategic review, Nasdaq supported the closing of the market operated by Nasdaq Europe, in which Nasdaq owned a 63.0% interest through December 18, 2003. At an Extraordinary General Meeting held on June 26, 2003, the shareholders of Nasdaq Europe voted to discontinue operations of the market and, as a result, market operations were wound-down pursuant to a Transition Plan approved by the Belgian Banking and Finance Commission.

As Nasdaq Europe was winding-down its market operations, Nasdaq reached an agreement to transfer all of Nasdaq's shares in Nasdaq Europe to one of that company's original investors; the cash consideration for the transaction was nominal. The transfer of Nasdaq's shares of Nasdaq Europe was completed on December 18, 2003. The entity ceased using the Nasdaq Europe name after the transaction and is now known as Easdaq. As part of the transaction, Nasdaq Europe's new owner committed to seek to restructure that company's obligations and, in that context, to request from certain major creditors releases of any claims they might have against Nasdaq Europe's former directors, officers and shareholders (if such claims are related to Nasdaq's prior ownership interest in Nasdaq Europe).

At the time of the transfer, Nasdaq Europe had \$15.1 million of external debt, accrued interest and other liabilities. Nasdaq recorded liabilities of \$15.1 million that management believed were sufficient to satisfy any potential claims against Nasdaq. Nasdaq and Easdaq entered into an agreement dated as of October 27, 2004, providing in relevant part that Easdaq was to reach agreements with certain of its creditors to settle these creditors' existing claims against Easdaq. On November 9, 2004, Nasdaq was provided evidence that these claims (related to Nasdaq's prior ownership interest in Nasdaq Europe) of certain Easdaq's creditors were satisfied or otherwise settled without any liability for Nasdaq. Nasdaq was the third party beneficiary of these creditor agreements and in the fourth quarter of 2004 released the \$15.1 million reserve it maintained in connection with such claims and liabilities. The release of the reserve was recorded as income from discontinued operations on the Consolidated Statements of Income.

Also, as part of Nasdaq's strategic review, during the third quarter of 2003, Nasdaq supported Nasdaq Europe's position in favor of the decision of the shareholders of Nasdaq Deutschland, a German exchange in which Nasdaq Europe had a 50.0% interest, to suspend that company's trading operations effective August 29, 2003. Nasdaq Europe transferred all of its shares in Nasdaq Deutschland to one of the other shareholders, BWB Holding AG, as of August 29, 2003. All shareholders of Nasdaq Deutschland agreed to release and discharge each other from certain claims that they may have had against each other in connection with certain agreements related to the operations and control of Nasdaq Deutschland.

The charge related to the orderly wind-down and liquidation of market operations in Belgium and Germany was approximately \$48.2 million (excluding the minority interest benefit of \$2.0 million) for the year ended December 31, 2003. The \$48.2 million charge includes the \$29.4 million impairment of certain technology

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**Table of Contents****The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

platforms held-for-sale and owned by Nasdaq Europe, the impairment of goodwill of \$8.1 million (Nasdaq Europe and Nasdaq Deutschland), severance costs of \$2.5 million and other costs of \$8.2 million including contract cancellations. During the third quarter of 2003, the losses incurred by Nasdaq Europe exceeded the minority shareholders' interests. Therefore, once the minority shareholders reached this point, Nasdaq absorbed 100.0% of Nasdaq Europe's losses and strategic review charges.

*Long-term Debt*

On September 30, 2003, Nasdaq redeemed \$150.0 million of its senior notes. In conjunction with its strategic review, Nasdaq reassessed its capital needs and determined that it no longer needed the liquidity of the senior notes. Nasdaq paid the holders of the senior notes \$150.0 million in outstanding principal amount, accrued interest of \$1.2 million and an aggregate make-whole payment of approximately \$12.6 million (representing the net present value of future payments). The repayment amounts reflected the terms of the senior notes, except that the parties agreed to a reduced make-whole amount equal to the excess of the discounted value of the remaining scheduled payments discounted at a factor equal to 100 basis points over the yield to maturity of U.S. Treasury securities having a maturity equal to the remaining average life of the redeemed amount. This represented a renegotiation of the 50 basis points over the yield to maturity required by the terms of the senior notes. Nasdaq recorded a \$13.2 million pre-tax charge in the third quarter of 2003 related to the redemption of the senior notes. This charge included the make-whole payment and capitalized costs related to the issuance of the senior notes. Nasdaq used funds from available cash and investments to finance the redemption.

*Nasdaq Member Revenue Sharing*

Effective June 1, 2002, Nasdaq terminated its market data revenue sharing program for securities listed on The Nasdaq Stock Market, as a result of the SEC's decision to abrogate certain market participant tape sharing pilot programs. The SEC's action was in response to concerns about the effect of market data rebates on the accuracy of market data and the regulatory functions of self-regulatory organizations. The SEC's action allows Nasdaq and competing exchanges to retain tape revenue. However, Nasdaq continues to share market data revenue with the exchanges that participate in the UTP Plan based on their respective share of volume and trades of securities listed on The Nasdaq Stock Market. In addition, Nasdaq continues to share tape revenue with Nasdaq market participants who report trades in the NYSE and the Amex-listed securities through Nasdaq.

In August 2003, Nasdaq implemented the Nasdaq General Revenue Sharing Program, which like the General Revenue Sharing Program of The National Stock Exchange, a regional stock exchange, shares operating revenue from multiple business lines in addition to tape fee revenue. The new discretionary program shares operating revenue, which is interpreted to mean net revenue after expenses from all services that derive revenue from member trading and trade-reporting activity in Nasdaq-listed securities. As such, the program is designed to provide an incentive for quoting market participants to send orders and report trades to the Nasdaq Market Center. Nasdaq did not share any revenues during 2003 under the General Revenue Sharing Program. For the year ended December 31, 2004, Nasdaq shared approximately \$20.1 million under this new program which is shown net within Market Services revenues. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," Market Services, for further discussion.

*Nasdaq Japan*

During the second quarter of 2002, Nasdaq recognized an other-than-temporary impairment charge on its equity investment in Nasdaq Japan. Nasdaq recognized this impairment as a result of the depressed level of market activity in Japan, combined with the suspension of Nasdaq Japan's hybrid trading system due to the inability to gain exchange approval of market rules and industry participation. These conditions led management

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Notes to Consolidated Financial Statements—(Continued)**

to conclude that Nasdaq Japan would not be profitable in the foreseeable future. As a result, Nasdaq Japan's financial liabilities to Nasdaq were not expected to be repaid and were recognized as a loss. Nasdaq Japan entered into liquidation status in late November 2002 and was completely dissolved by the end of May 2003.

The net impact of the other-than-temporary impairment on Nasdaq's pre-tax income was \$15.2 million. This represented a complete write-down of the investment, outstanding and unfunded loans (an additional \$6.0 million was loaned and \$7.0 million was committed), foreign exchange translation losses and other receivables, partially offset by a re-valuation of certain variable Nasdaq Japan stock based awards of approximately \$7.9 million.

During the second quarter of 2003, Nasdaq reversed \$5.0 million of the reserves related to Nasdaq Japan due to favorable contract negotiations and lower legal costs resulting from the complete liquidation of Nasdaq Japan.

*Other Restructuring and Related Party Transactions*

In conjunction with settling various issues associated with the Restructuring, NASD made a payment to Nasdaq in the amount of \$5.6 million during the first quarter of 2002. Nasdaq treated the payment as a contribution and reflected it in additional paid-in capital in its Consolidated Balance Sheets. In addition, during December 2002, Nasdaq purchased NASD's 50.0% interest in NASD Insurance Agency, LLC (subsequently renamed the Nasdaq Insurance Agency, LLC ("Nasdaq Insurance Agency") or ("NIA")) for \$0.5 million. The payment was recorded as a distribution to NASD. The agency provides insurance brokerage services and specializes in the director and officer liability insurance market. Nasdaq accounts for its investment in the Nasdaq Insurance Agency under the equity method of accounting as of December 31, 2004. Nasdaq believes that the Nasdaq Insurance Agency was a Variable Interest Entity under FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of Accounting Research Bulletin No. 51" ("FIN 46") and its amendment entitled FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" ("FIN 46(R)"). However, Nasdaq does not believe that it is the primary beneficiary of the NIA and therefore did not consolidate the NIA in its results of operations.

On January 1, 2005, Nasdaq purchased the remaining 50.0% interest in the Nasdaq Insurance Agency from AIG NJV, Inc. for nominal consideration. See Note 23, "Subsequent Events," for further discussion.

*QQQ Lists on Nasdaq*

On December 1, 2004, the Nasdaq-100 Index Tracking Stock ("QQQ") transferred its listing to Nasdaq from Amex. Nasdaq and Amex reached a mutual decision to transfer the QQQ earlier than the contractual date of June 2005. It trades under the symbol "QQQQ."

**4. Acquisition of Brut**

As previously discussed, on September 7, 2004 (See "Acquisition of Brut," of Note 3, "Significant Transactions"), Nasdaq announced the completion of its acquisition of Brut and related entities, including Toll, from SunGard for a total consideration of \$190.0 million in cash, subject to certain post-closing adjustments. In addition, Nasdaq incurred direct costs of \$3.1 million associated with the acquisition. Nasdaq accounted for the acquisition under the purchase method of accounting. Brut and related affiliates are included within the Market Services segment.

Nasdaq had not finalized the allocation of the purchase price as of December 31, 2004. Nasdaq expects future adjustments related to taxes and settlement of post-closing adjustments. An estimation of the purchase

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

price allocation as of September 7, 2004 was prepared and included as part of these financial statements. The initial purchase price was allocated as follows:

	(in thousands)
<b>Net assets acquired:</b>	
Accounts receivable, net	\$ 19,240
Deferred tax asset	486
Other current assets	182
Property and equipment, net	3,433
Intangible assets	5
Other assets	20
Accounts payable and accrued expenses	(14,248)
Accrued personnel costs	(2,198)
Non-current deferred tax liability	(523)
Accumulated other comprehensive loss	(127)
	\$ 6,270
Goodwill	141,730
Intangible assets	42,000
	\$ 190,000
	\$ 190,000

During the fourth quarter of 2004, Nasdaq adjusted the initial allocation of the purchase price. Goodwill decreased from \$141.7 million to \$141.4 million primarily due to a decrease in Nasdaq's estimate of severance liability for Brut employees. Nasdaq does not expect future adjustments to the purchase price to be significant. Nasdaq expects to deduct \$2.7 million of goodwill for income tax purposes for the year ended December 31, 2004.

The following table presents details of the identifiable intangible assets acquired in the Brut acquisition:

	Amount	Estimated Average Useful Life
	(in thousands)	(in years)
<i>Identifiable intangible assets:</i>		
Technology	\$ 15,700	10.0
Customer relationships	26,300	10.0
	\$ 42,000	
Total	\$ 42,000	

Both the goodwill and intangible assets related to the acquisition of Brut are included on the books and records of Brut and in the Market Services segment.

The unaudited pro forma combined historical results for the year ended December 31, 2004 and 2003, as if Nasdaq had acquired Toll and related entities at the beginning of fiscal 2003, are estimated to be:

	Year Ended December 31,	
	2004	2003
	(in thousands, except per share amounts)	
Revenues	\$663,666	\$706,212

Gross margin	496,955	606,875
Net income (loss) from continuing operations	881	(48,099)
Basic and diluted loss per share	\$ (0.16)	\$ (0.72)

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The pro forma results include amortization of the intangibles presented above and the elimination of intercompany transactions had Nasdaq and Toll acted as a combined company. The pro forma results are not necessarily indicative of what actually would have occurred if the acquisition had been completed as of the beginning of 2003, nor are they necessarily indicative of future consolidated results.

The integration of Brut's services into Nasdaq is designed to be seamless to both Nasdaq and Brut customers. Brut continues to operate under the Brut name as a broker-dealer; however, it operates as part of The Nasdaq Stock Market. Brut is subject to the SEC's Uniform Net Capital Rule (the "Rule"), which requires the maintenance of minimum net capital. Brut has elected to use the basic method permitted by the Rule to determine its net capital, which requires Brut maintain minimum net capital equal to the greater of \$100,000 or 6 2/3% of aggregate indebtedness, as defined. The rule also requires that aggregate indebtedness not exceed 15 times net capital. At December 31, 2004, Brut had net capital of \$8.1 million, which was \$6.4 million in excess of its required net capital of \$1.7 million.

Brut results are included for the period September 7, 2004 through December 31, 2004 in the Consolidated Statements of Income.

**5. Discontinued Operations**

On September 30, 2003, Nasdaq Global sold its interest in IndigoMarkets to its partner, SSI Limited, and recognized a gain of approximately \$0.6 million on the sale. In addition, on December 18, 2003, Nasdaq transferred its interest in Nasdaq Europe to one of that company's original investors for nominal cash consideration. In the fourth quarter of 2004, Nasdaq recognized a gain on the release of a reserve for potential claims against Nasdaq that management established at the time of the transfer of Nasdaq's shares of Nasdaq Europe. In the fourth quarter of 2004, Nasdaq reached agreements with certain of its creditors to settle these creditors' existing claims against Nasdaq. Nasdaq was the third party beneficiary of these creditor agreements and released the \$15.1 million reserve management established. See "Strategic Review," of Note 3, "Significant Transactions," for further discussion.

In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets" ("SFAS 144"), both Nasdaq Europe and IndigoMarkets are reflected as discontinued operations for all years presented. As discontinued operations, the revenues, costs and expenses and cash flows of Nasdaq Europe and IndigoMarkets have been excluded from the respective captions in the Consolidated Statements of Income and Consolidated Statements of Cash Flows, and have been presented separately as "Income (loss) from discontinued operations, net of tax" and as "Cash provided by (used in) discontinued operations." There were no assets and liabilities of Nasdaq Europe and IndigoMarkets at December 31, 2004 and 2003.

The following table presents condensed, combined results of operations for Nasdaq Europe and IndigoMarkets.

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Revenues	\$ —	\$ 10,632	\$ 11,616
Pre-tax income (loss)	15,154	(63,998)	(21,765)
(Provision) benefit for income taxes	(5,596)	3,663	(128)
Income (loss) from discontinued operations	<u>\$ 9,558</u>	<u>\$(60,335)</u>	<u>\$(21,893)</u>

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

The remainder of the notes to the consolidated financial statements reflects results from continuing operations, unless otherwise noted.

**6. Deferred Revenue**

Nasdaq's deferred revenue as of December 31, 2004 relating to Corporate Client Group fees will be recognized in the following years:

	Initial Listing Fees	Listing of Additional Shares	Annual and Other	Total
	(in thousands)			
Fiscal year ended:				
2005	\$27,306	\$ 32,231	\$ —	\$ 59,537
2006	17,101	21,873	—	38,974
2007	12,075	15,603	—	27,678
2008	9,407	5,351	—	14,758
2009 and thereafter	8,411	—	—	8,411
	<u>\$74,300</u>	<u>\$ 75,058</u>	<u>\$ —</u>	<u>\$149,358</u>

Nasdaq's deferred revenue for the year ended December 31, 2004 and 2003 is reflected in the following tables. The additions reflect Corporate Client Group revenues charged during the year while the amortization reflects Corporate Client Group revenues recognized during the year in accordance with GAAP.

	Initial Listing Fees	Listing of Additional Shares	Annual and Other	Total
	(in thousands)			
Balance at January 1, 2004	\$ 78,485	\$ 65,957	\$ —	\$ 144,442
Additions	26,905	45,846	97,446	170,197
Amortization	(31,090)	(36,745)	(97,446)	(165,281)
Balance at December 31, 2004	<u>\$ 74,300</u>	<u>\$ 75,058</u>	<u>\$ —</u>	<u>\$ 149,358</u>

	Initial Listing Fees	Listing of Additional Shares	Annual and Other	Total
	(in thousands)			
Balance at January 1, 2003	\$ 93,857	\$ 72,841	\$ —	\$ 166,698
Additions	16,886	30,206	97,964	145,056
Amortization	(32,258)	(37,090)	(97,964)	(167,312)
Balance at December 31, 2003	<u>\$ 78,485</u>	<u>\$ 65,957</u>	<u>\$ —</u>	<u>\$ 144,442</u>

**7. Real Estate Developments***New York*

In 2001, Nasdaq recorded a sublease loss reserve of \$21.5 million in anticipation of relocating its headquarters location from One Liberty Plaza to 1500 Broadway. Nasdaq signed a lease commencing May 1, 2002 at 1500 Broadway. Later in 2002, Nasdaq's management reconsidered its decision to relocate to 1500 Broadway and decided to maintain its headquarters at One Liberty Plaza. Nasdaq maintained the initial reserve

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Notes to Consolidated Financial Statements—(Continued)**

recorded in 2001 (including interest accretion) for the sublease loss at 1500 Broadway. At December 31, 2003, the estimated loss on the sublease was approximately \$20.5 million. In 2004, Nasdaq signed subleases for all of its space at 1500 Broadway. At December 31, 2004, Nasdaq updated the sublease loss estimate based on current assumptions and known sublease incomes and recorded an additional loss of \$1.2 million to general and administrative expense in the Consolidated Statements of Income. The additional loss was primarily due to a change in the assumption of sublease term commencement dates. At December 31, 2004, the estimated sublease loss reserve was approximately \$18.0 million. The estimated reserve was adjusted throughout the year to reflect interest accretion, rental payments made during 2004 and depreciation on leasehold improvements. The estimated loss was calculated using a 7.5% net discount rate and estimated 21-year sublease terms commencing in 2004 and 2005 at estimated market rates.

In 2001, Nasdaq also signed a lease for expansion space on one of the floors it occupied at One Liberty Plaza, which was to commence on October 1, 2004. Nasdaq's management does not intend to occupy this space and began marketing the expansion space for sublease during the third quarter of 2004. Nasdaq is obligated under the terms of the expansion space lease to pay \$33.9 million over the remaining life of the lease and recorded a sublease loss reserve of \$12.8 million, which is included in general and administrative expense in the Consolidated Statements of Income. In addition, in the fourth quarter of 2004, Nasdaq's management decided that it no longer needed the space it currently occupied on the expansion floor and recorded an additional estimated sublease loss reserve of \$4.8 million for the remaining space. This charge is also included in general and administrative expense in the Consolidated Statements of Income. Nasdaq is obligated under the terms of this lease to pay \$12.6 million over the remaining useful life of the lease. Both estimated losses for One Liberty Plaza were calculated using a 7.5% net discount rate and estimated 17-year sublease term commencing in January 2006 at estimated market rates.

*New Jersey*

As a part of Nasdaq's strategic review, Nasdaq vacated the space Nasdaq Tools occupied at 15 Exchange Place, Jersey City, New Jersey. As of December 31, 2003 Nasdaq was obligated under the terms of this lease to pay \$2.8 million over the remaining life of the lease and recorded a sublease loss reserve of \$1.2 million, which was included in the elimination of non-core product lines, initiatives and severance in the Consolidated Statements of Income. At December 31, 2004, Nasdaq updated the sublease loss reserve based on current assumptions and recorded an additional loss of \$0.2 million to general and administrative expense in the Consolidated Statements of Income. The estimated loss was calculated using a 7.5% net discount rate and estimated 6-year sublease term commencing in the beginning of 2005 at estimated market rates. Nasdaq is currently actively marketing the space and has signed a sublease agreement for approximately 50.0% of the space. At December 31, 2004, the sublease loss reserve was approximately \$0.8 million. The estimated loss was adjusted throughout the year to reflect interest accretion and rental payments made during the 2004.

*Maryland*

During 2003, Nasdaq decided to vacate part of the space it occupies in Rockville, Maryland located at 9600 Blackwell and recorded a sublease loss reserve of \$2.3 million, which was included in general and administrative expense in the Consolidated Statements of Income. Nasdaq's management re-evaluated its decision to vacate the space at 9600 Blackwell and decided instead to sell the building it owns and occupies in Rockville, Maryland located at 9513 Key West Avenue. Based on Nasdaq's management's revised decision, Nasdaq released the sublease loss reserve recorded for 9600 Blackwell which totaled \$1.9 million, net of rental payments, in September 30, 2004, which is recorded in general and administrative expense in the Consolidated Statements of Income.

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Nasdaq began actively marketing the 9513 Key West building for sale in the fourth quarter of 2004 and expects the building to be sold within a year. During the fourth quarter of 2004, Nasdaq recognized a \$7.4 million loss, which is included in general and administrative expense in the Consolidated Statement of Income, on the write-down of the building's carrying amount to fair market value less cost to sell. Fair value was determined using a quoted market price from an independent third party.

*Connecticut*

In 2004, Nasdaq also evaluated its real estate needs in Trumbull, Connecticut. Nasdaq currently owns and occupies a building located at 80 Merritt Boulevard and leases and occupies another building located at 35 Nutmeg Drive. Nasdaq's management determined that based on staff reductions, all employees in Trumbull will consolidate into Nasdaq's building at 80 Merritt Boulevard. Although Nasdaq's lease at 35 Nutmeg Drive terminates in July 2008, Nasdaq plans on moving all employees from 35 Nutmeg Drive to 80 Merritt Boulevard by the end of 2005. As a result, Nasdaq expects to record a charge of approximately \$2.5 million in the fourth quarter of 2005 when it completely vacates 35 Nutmeg Drive for its remaining lease obligation. In order to accommodate all employees in the Merritt building, two data center spaces will be converted into office space. The data centers will cease being used by the end of the first quarter of 2005, and accordingly, Nasdaq began accelerating the data centers' fixed assets and leasehold improvements over the new estimated useful life. Nasdaq recorded \$4.5 million of accelerated depreciation for the data center assets for the year ended December 31, 2004 and will record an additional \$2.2 million in the first quarter of 2005.

**8. Investments**

Investments consist of U.S. Treasury securities, obligations of U.S. Government sponsored enterprises, municipal bonds, auction rate securities and other financial instruments. Following is a summary of investments classified as available-for-sale that are carried at fair value as of December 31, 2004:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 57,900	\$ —	\$ 693	\$ 57,207
Obligations of states and political subdivisions	53,248	86	897	52,437
Auction rate securities	46,125	—	—	46,125
U.S. corporate securities	19,234	—	90	19,144
Total	\$176,507	\$ 86	\$ 1,680	\$174,913

At December 31, 2004, all held-to-maturity investments consisted of U.S. Treasury securities and obligations of U.S. Government agencies. The cost of the securities was \$30.6 million and had gross unrealized losses of \$0.4 million and a total estimated fair value of \$30.2 million at December 31, 2004. Of the \$0.4 million of gross unrealized losses 98.9% have been in an unrealized loss position for less than 12 months and are deemed to be temporary.

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

Following is a summary of investments classified as available-for-sale which are carried at fair value as of December 31, 2003:

	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
U.S. Treasury securities and obligations of U.S. Government agencies	\$112,700	\$ 169	\$ 254	\$112,615
Obligations of states and political subdivisions	13,966	125	9	14,082
Asset-backed securities	10,708	62	—	10,770
U.S. corporate securities	48,229	62	54	48,237
<b>Total</b>	<b>\$185,603</b>	<b>\$ 418</b>	<b>\$ 317</b>	<b>\$185,704</b>

At December 31, 2003, all held-to-maturity investments consisted of U.S. Treasury securities and obligations of U.S. Government agencies. The cost of the securities was \$28.3 million and had gross unrealized gains of \$54 thousand and a total estimated fair value of \$28.3 million at December 31, 2003.

The following table shows the fair value of our available-for-sale investments in an unrealized loss position deemed to be temporary for less than 12 months at December 31, 2004 and 2003:

	December 31, 2004		December 31, 2003	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
		(in thousands)		
U.S. Treasury securities and obligations of U.S. Government agencies	\$ 57,207	\$ 693	\$31,805	\$ 254
Obligations of states and political subdivisions	50,647	897	6,013	9
U.S. corporate securities	14,970	69	23,087	54
<b>Total</b>	<b>\$122,824</b>	<b>\$ 1,659</b>	<b>\$60,905</b>	<b>\$ 317</b>

At December 31, 2004, the amount of investments in an unrealized loss position deemed to be temporary for more than 12 months was immaterial. At December 31, 2003, Nasdaq did not have any investments in an unrealized loss position deemed to be temporary for more than 12 months.

The cost and estimated fair value of debt securities classified as available-for-sale that are carried at fair value at December 31, 2004, by contractual maturity, are shown below.

	Cost	Gross Unrealized		Fair Value
		Gain	Loss	
		(in thousands)		
Due in one year or less		—		
	\$ 88,384	\$	\$ 576	\$ 87,808
Due after one through five years	88,123	86	1,104	87,105
<b>Total</b>	<b>\$176,507</b>	<b>\$86</b>	<b>\$1,680</b>	<b>\$174,913</b>

All investments classified as held-to-maturity mature in 2005 and 2006 in the amounts of \$28.6 million and \$2.0

million, respectively.

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**Table of Contents****The Nasdaq Stock Market, Inc.****Notes to Consolidated Financial Statements—(Continued)**

During the year ended December 31, 2004 debt available-for-sale securities with a fair market value at the date of sale of \$173.2 million were sold. During the years ended December 31, 2003 and 2002, debt and equity available-for-sale securities with a fair market value at the date of sale of \$86.5 million and \$209.8 million, respectively, were sold. For the years ended December 31, 2004, 2003 and 2002, the gross realized gains on such sales totaled \$0.1 million, \$1.7 million and \$3.0 million, respectively and the gross realized losses totaled \$0.3 million, \$1.1 million and \$2.9 million, respectively. The net adjustment after tax to unrealized holding losses on available-for-sale securities included as a separate component of stockholders' equity totaled \$1.0 million, \$0.2 million and \$1.1 million for 2004, 2003 and 2002, respectively. The net adjustment after tax to unrealized gains (losses) on available-for-sale securities included as a separate component of stockholders' equity due to the sale of securities totaled \$0.1 million, \$1.0 million and \$(0.9) million for 2004, 2003 and 2002, respectively.

In accordance with SFAS 115, Nasdaq recognized pre-tax charges of \$0.9 million and \$1.0 million for the years ended December 31, 2003 and 2002, respectively, attributable to the impairment of five and 11, respectively publicly-traded equity securities. The impairment charges were related to the decline in the fair value of Nasdaq's publicly-traded equity investments below their cost basis that were judged to be other-than-temporary. Nasdaq recorded the impairment losses in the Consolidated Statements of Income and adjusted the cost basis of respective securities down to fair value as a new cost basis. As of December 31, 2003, all equity securities including those impaired were sold.

At December 31, 2004 and 2003, investments with a carrying value of approximately \$30.6 million and \$28.3 million were pledged as collateral for Nasdaq's \$25.0 million note payable. Collateral is limited to U.S. Government and Agency securities with a margined value of not less than 100.0% of the loan and is invested in accordance with the note agreement. See Note 11, "Senior Notes," for further discussion.

**9. Goodwill and Intangible Assets**

The following table outlines goodwill by reportable segment:

	Market Services	Issuer Services	Total
	(in thousands)		
Balance as of December 31, 2003	\$ —	\$ —	\$ —
Additions <sup>(1)</sup>	141,381	—	141,381
Balance as of December 31, 2004	\$141,381	\$ —	\$141,381

(1) See Note 4, "Acquisition of Brut," for further discussion.

The following table summarizes intangible assets, net by reportable segment:

	Market Services		Issuer Services		Other		Total	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
	(in thousands)							
Technology <sup>(2)</sup>	\$15,700	\$ (666)	\$ —	\$ —	\$ —	\$ —	\$15,700	\$ (666)
Customer relationships <sup>(2)</sup>	26,300	(935)	—	—	—	—	26,300	(935)
Pension intangible assets <sup>(3)</sup>	—	—	—	—	318	—	318	—
Other	5	—	350	(281)	—	—	355	(281)
Total	\$42,005	\$ (1,601)	\$ 350	\$ (281)	\$ 318	\$ —	\$42,673	\$ (1,882)

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Notes to Consolidated Financial Statements—(Continued)**

- (2) Both the technology and customer relationships intangible assets are being amortized over a ten-year estimated average useful life ending 2014. Amortization expense for the next five years commencing in 2005 is expected to be \$4.8 million, \$4.3 million, \$4.2 million, \$4.1 million and \$4.1 million, respectively.
- (3) Pension intangible assets were recorded as required by SFAS No. 87, "Employers' Accounting for Pensions." Amounts are not amortized but are adjusted as part of the annual minimum pension liability assessment.

**10. Fair Value of Financial Instruments**

Nasdaq considers cash and cash equivalents, investments, receivables, net, receivables and payables with related parties, accounts payable and accrued expenses, accrued personnel costs, Senior Notes and Subordinated Notes to be its financial instruments. The carrying amounts reported in the Consolidated Balance Sheets for the above financial instruments, except for the Senior and Subordinated Notes closely approximates their fair values due to the short-term nature of these assets and liabilities. The approximate fair value of Nasdaq's Senior Notes and Subordinated Notes were estimated using 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 these obligations at December 31, 2004 and 2003 approximates their carrying amounts.

**11. Senior Notes**

On September 30, 2003, Nasdaq redeemed its \$150.0 million outstanding principal amount of the senior notes. Under the terms of the senior notes, Nasdaq paid the holders of the senior notes \$150.0 million in outstanding principal amount, accrued interest of \$1.2 million and an aggregate make-whole payment of approximately \$12.6 million (representing the net present value of future payments). Nasdaq recorded a \$13.2 million pre-tax charge in the third quarter of 2003 related to the redemption of the senior notes. This charge included the make-whole payment and capitalized costs related to the issuance of the senior notes. Nasdaq used funds from available cash and investments to finance the redemption. See "Long-term Debt," of Note 3, "Significant Transactions," for further discussion. Interest expensed and paid under the senior notes totaled approximately \$6.5 million and \$5.6 million for the years ended December 31, 2003 and 2002, respectively.

In May 1997, Nasdaq entered into a \$25.0 million note payable with a financial institution (the "Lender"). Principal payments are scheduled to begin in 2007 and continue in equal monthly installments until maturity in 2012. The note requires monthly interest payments through May 2007 at an annual rate of 7.41%. After May 2007, Nasdaq will incur interest equal to the Lender's cost of funds rate, as defined in the agreement, plus 0.5%. Interest expensed and paid under the agreement totaled approximately \$1.9 million for each of the years ended December 31, 2004, 2003 and 2002.

**12. Subordinated Notes**

On May 3, 2001, Nasdaq issued and sold \$240.0 million in aggregate principal amount of 4.0% convertible subordinated notes due 2006 to Hellman & Friedman Capital Partners IV, L.P. and certain of its affiliated limited partnerships (collectively, "Hellman & Friedman"). Until Nasdaq is granted Exchange Registration, Hellman & Friedman may only exercise its conversion rights for a number of shares of common stock such that immediately following such conversion, NASD will continue to control greater than 50.0% of the combined voting power of Nasdaq. The annual 4.0% coupon will be payable in arrears and the Subordinated Notes are convertible at any time into an aggregate of 12.0 million shares of common stock at \$20.00 per share, subject to adjustment, in general, for any stock split, dividend, combination, recapitalization or other similar event. Interest expensed and paid under the agreement totaled approximately \$9.6 million for each of the years ended December 31, 2004, 2003 and 2002.

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

In 2002, Nasdaq stockholders approved an amendment to Nasdaq's Restated Certificate of Incorporation (the "Certificate of Incorporation") that provided for voting debt. As a result, the holders of the Subordinated Notes may vote on an as-converted basis on all matters on which holders of common stock have the right to vote, subject to the current 5.0% voting limitation in the Certificate of Incorporation. Nasdaq has granted Hellman & Friedman certain registration rights with respect to the shares of common stock underlying the Subordinated Notes.

On an as-converted basis as of December 31, 2004, Hellman & Friedman owned an approximate 13.7% equity interest in Nasdaq as a result of its ownership of these Subordinated Notes and 500,000 shares of common stock purchased from Nasdaq in a separate transaction. Hellman & Friedman is permitted to designate one person reasonably acceptable to Nasdaq for nomination as a director of Nasdaq for so long as Hellman & Friedman owns Subordinated Notes and/or shares of common stock issued upon conversion thereof representing at least 50.0% of the shares of common stock issuable upon conversion of the Subordinated Notes initially purchased. Patrick Healy, a managing director of Hellman & Friedman, was designated by Hellman & Friedman and currently serves on the Board of Directors.

**13. Income Taxes**

The income tax (provision) benefit from continuing operations consists of the following amounts:

	Year Ended December 31,		
	2004	2003	2002
	(in thousands)		
Current income taxes:			
Federal	\$ 24,741	\$ 26,753	\$ (21,812)
State	(208)	(11)	(5,204)
Foreign	(3,908)	(2,790)	(243)
Total current income taxes	<u>20,625</u>	<u>23,952</u>	<u>(27,259)</u>
Deferred income taxes:			
Federal	(22,506)	(7,180)	(11,259)
State	(68)	4,468	(2,403)
Foreign	1,200	—	—
Total deferred income taxes	<u>(21,374)</u>	<u>(2,712)</u>	<u>(13,662)</u>
Total income tax (provision) benefit	<u>\$ (749)</u>	<u>\$ 21,240</u>	<u>\$ (40,921)</u>
Income taxes (refunded) paid during the year	<u>\$ (49,986)</u>	<u>\$ (25,936)</u>	<u>\$ 77,187</u>

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A reconciliation of the income tax (provision) benefit, based on the U.S. federal statutory rate, to Nasdaq's actual income tax (provision) benefit from continuing operations for the years ended December 31, 2004, 2003 and 2002 is as follows:

	Year Ended December 31,		
	2004	2003	2002
	(in thousands)		
Federal income tax (provision) benefit at the statutory rate	\$ (894)	\$23,223	\$(37,080)
State income tax (provision) benefit, net of federal effect	(179)	2,897	(4,944)
Change in valuation allowance—foreign losses	1,051	(1,468)	(2,501)
Foreign taxes	(872)	—	—
Tax preferred investments	601	681	780
Nondeductible expenses	(926)	(1,410)	(817)
Tax credits	—	1,711	2,341
Goodwill impairment	—	(1,431)	—
Prior year tax payable	496	(2,904)	—
Other	(26)	(59)	1,300
Actual income tax (provision) benefit	\$ (749)	\$21,240	\$(40,921)

The temporary differences, which give rise to Nasdaq's deferred tax assets and (liabilities) consisted of the following:

	December 31,	
	2004	2003
	(in thousands)	
Deferred tax assets:		
Deferred fees	\$ 33,217	\$ 56,624
Foreign net operating loss	1,506	1,576
State net operating loss	4,911	5,466
Technology costs	1,231	3,680
Compensation and benefits	12,365	8,252
Lease reserves	14,022	7,949
Capital loss carryforward	6,903	7,102
Strategic review charges	3,113	16,326
Other	3,135	14,242
Gross deferred tax assets	80,403	121,217
Deferred tax liabilities:		
Depreciation	(2,591)	(8,269)
Software development costs	(26,923)	(31,843)
Other	(373)	(3,198)
Gross deferred tax liabilities	(29,887)	(43,310)
Net deferred tax asset before valuation allowance	50,516	77,907
Less: Valuation allowance	(7,429)	(8,678)
Net deferred tax asset	\$ 43,087	\$ 69,229

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Of the \$4.9 million of state and the \$1.5 million of foreign net operating losses at December 31, 2004, state losses of \$4.9 million will expire through 2023, foreign losses of \$0.4 million will expire 2007 through 2011 and \$1.1 million have no expiration date. Of the \$6.9 million of capital loss carryforwards, \$0.7 million will expire 2006 through 2008 and \$6.2 million will expire in 2009.

The change in the valuation allowance from December 31, 2003 to December 31, 2004 is as follows:

	<u>(in thousands)</u>
Balance at December 31, 2003	\$ (8,678)
Utilization of prior year foreign net operating losses in the current period	1,200
Foreign net operating loss carryforwards generated in 2004	(149)
State tax effect of prior year valuation allowance	626
Capital loss carryforwards generated in 2004	(428)
Balance at December 31, 2004	<u>\$ (7,429)</u>

Not included in the deferred tax assets for the year ended December 31, 2004 is a capital loss carryforward of \$15.8 million generated through discontinued operations. The carryforward will expire in 2008 and Nasdaq believes that it is more likely than not that no benefit will be realized on this asset. Therefore, a valuation allowance of \$15.8 million was established.

The following represents the domestic and foreign components of income (loss) from continuing operations before income tax (benefit) expense:

	<u>Year Ended December 31,</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
		<u>(in thousands)</u>	
Domestic	\$(1,122)	\$(75,114)	\$113,715
Foreign	3,675	8,762	(7,773)
Income (loss) before income tax (expense) benefit	<u>\$ 2,553</u>	<u>\$(66,352)</u>	<u>\$105,942</u>

**14. Employee Benefits**

Nasdaq is a participating employer in a noncontributory, defined-benefit pension plan that NASD sponsors for the benefit of its eligible employees and the eligible employees of its subsidiaries. As of January 1, 2004, the benefits are primarily based on years of service and the employees' career-average salary during employment, subject to a phase-in period. Prior to 2004, the benefits were primarily based on years of service and the employees' average salary during the highest 60 consecutive months of employment.

Until November 1, 2003, Nasdaq participated in a Supplemental Executive Retirement Plan ("SERP") that was maintained by NASD for certain senior executives. On November 1, 2003, Nasdaq formed its own SERP and transferred all amounts to this new plan. Also during 2003, Nasdaq changed the accrual of benefits from age 65 to the later of age 55 or 10 years of service, except in the case of an executive who has a contract with a SERP provision, then benefits are accrued in accordance with the contract terms.

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

The following table sets forth the pension and SERP plans funded status as of December 31:

	2004			2003		
	Pension	SERP	Total	Pension	SERP	Total
	(in thousands)					
<b>Change in benefit obligation</b>						
Benefit obligation at beginning of year	\$ 60,961	\$ 18,881	\$ 79,842	\$ 70,100	\$ 12,001	\$ 82,101
Service cost	5,106	1,361	6,467	5,700	2,775	8,475
Interest cost	3,440	921	4,361	3,905	1,290	5,195
Actuarial (gains) losses	(5,659)	(499)	(6,158)	(683)	1,213	530
Benefits paid	(9,215)	(4,984)	(14,199)	(14,698)	(5,813)	(20,511)
Plan amendments	—	—	—	(10,233)	6,933	(3,300)
Loss due to change in discount rate	5,922	455	6,377	6,870	482	7,352
Gain due to change in salary scale	(3,189)	—	(3,189)	—	—	—
<b>Benefit obligation at end of year</b>	57,366	16,135	73,501	60,961	18,881	79,842
<b>Change in plan assets</b>						
Fair value of plan assets at beginning of year	32,988	—	32,988	34,351	—	34,351
Net employee transfers into plan	—	—	—	502	—	502
Actual return on plan assets	2,467	—	2,467	7,780	—	7,780
Company contributions	6,044	4,984	11,028	5,053	5,813	10,866
Benefits paid	(9,215)	(4,984)	(14,199)	(14,698)	(5,813)	(20,511)
<b>Fair value of plan assets at end of year</b>	32,284	—	32,284	32,988	—	32,988
Underfunded status of the plan	(25,082)	(16,135)	(41,217)	(27,973)	(18,881)	(46,854)
Unrecognized net actuarial loss	18,754	3,545	22,299	22,051	3,840	25,891
Unrecognized prior service cost	(8,100)	318	(7,782)	(8,744)	686	(8,058)
Unrecognized transition asset	(164)	—	(164)	(221)	—	(221)
<b>Accrued benefit cost</b>	\$ (14,592)	\$(12,272)	\$(26,864)	\$ (14,887)	\$(14,355)	\$(29,242)
<b>Accumulated benefit obligation</b>	\$ 43,011	\$ 15,632	\$ 58,643	\$ 41,020	\$ 17,336	\$ 58,356
<b>Weighted-average assumptions as of December 31:</b>						
Discount rate	5.75%	5.75%		6.25%	6.25%	
Expected return on plan assets	8.75	—		8.75	—	
Rate of compensation increase	4.50	4.00		5.50	4.00	

The following table sets forth the combined plans' amounts recognized in the Consolidated Statements of Income:

	Year Ended December 31,		
	2004	2003	2002
	(in thousands)		
<b>Components of net periodic benefit cost</b>			
Service cost	\$ 6,467	\$ 8,475	\$ 7,460
Interest cost	4,361	5,195	4,971
Expected return on plan assets	(2,974)	(2,899)	(3,529)
Amortization of unrecognized transition asset	(58)	(57)	(58)

Recognized net actuarial loss/(gain)	902	1,247	(413)
Prior service cost recognized	(319)	5,004	474
Curtailment/settlement loss recognized	207	2,112	1,248
	<u>          </u>	<u>          </u>	<u>          </u>
<b>Benefit cost</b>	<b>\$ 8,586</b>	<b>\$19,077<sup>(1)</sup></b>	<b>\$10,153</b>
	<u>          </u>	<u>          </u>	<u>          </u>

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

- (i) Includes strategic review amounts related to the fulfillment of employment SERP contracts and obligations associated with the retirement and departure of certain members of senior management. See “Strategic Review,” of Note 3, “Significant Transactions,” for further discussion.

The investment policy and strategy of the plan assets, as established by NASD Pension Plan Committee, is to provide for preservation of principal, both in nominal and real terms, in order to meet the long-term spending needs of the pension plan by investing assets per the target allocations stated below. Asset allocations are reviewed quarterly and adjusted, as appropriate, to remain within target allocations. The investment policy is reviewed on an annual basis, under the advisement of an investment consultant, to determine if the policy or asset allocation targets should be changed. The policy was changed in 2004 and transition to the revised asset allocation strategy was in process as of December 31, 2004. The plan assets consisted of the following as of December 31:

	<u>Target Allocation</u>	<u>2004</u>	<u>2003</u>
Equity securities	45.0% - 75.0%	65.5%	74.0%
Debt securities and cash equivalents	10.0% - 40.0%	26.0	26.0
Other investment strategies	10.0% - 20.0%	8.5	—
<b>Total</b>		<u>100.0%</u>	<u>100.0%</u>

The expected long-term rate of return for the plan’s total assets is based on the expected return of each of the above categories, weighted based on the current target allocation for each class. Equity securities are expected to return 8.0% to 10.0% over the long-term, other investment strategies are anticipated to yield 6.0% and 8.0%, while cash and fixed income is expected to return between 4.0% and 6.0%. Based on historical experience, the committee expects that the plan’s asset managers overall will provide a modest (1.0% per annum) premium to their respective market benchmark indices.

The pension and SERP plans are measured at the beginning of each fiscal year. Based on the current Internal Revenue Service regulations, Nasdaq expects to contribute approximately \$8.9 million to the pension plan in 2005. This includes \$5.1 million for the 2004 plan year contribution and \$3.8 million for the 2005 plan year. The SERP is an unfunded plan.

Nasdaq expects to make the following benefit payments to participants in the next ten fiscal years:

	<u>Pension</u>	<u>SERP</u>	<u>Total</u>
	(in thousands)		
Fiscal year ended:			
2005	\$ 1,656	\$ 571	\$ 2,227
2006	2,592	7,885	10,477
2007	3,067	3,078	6,145
2008	3,665	670	4,335
2009	3,471	657	4,128
2010 through 2014	24,858	5,008	29,866
	<u>\$ 39,309</u>	<u>\$ 17,869</u>	<u>\$57,178</u>

During 2004, 2003 and 2002, there were settlement losses of \$0.2 million, \$2.1 million and \$1.2 million, respectively for employees included within the SERP plan due to early retirements.

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Notes to Consolidated Financial Statements—(Continued)**

Pursuant to the provisions of SFAS 87 related to the SERP, an intangible asset of \$1.0 million and an adjustment to stockholders' equity of \$1.4 million (net of tax of \$0.9 million), were recorded as of December 31, 2001 to recognize the minimum pension liability. During 2002, the intangible asset and adjustment to stockholders' equity both were reduced to \$0.6 million and \$1.1 million (net of tax of \$0.7 million), respectively. During 2003, the intangible asset and the minimum pension liability were adjusted to \$0.7 million and \$1.4 million (net of tax of \$0.9 million), respectively. As of December 31, 2004, the intangible asset and the minimum pension liability were \$0.3 million and \$1.8 million (net of tax of \$1.2 million), respectively.

Prior to April 1, 2002, Nasdaq participated in a voluntary savings plan for eligible employees of NASD and its subsidiaries. As of April 1, 2002, in accordance with the Restructuring, Nasdaq formed its own voluntary savings plan and all amounts were transferred to this new plan. This voluntary savings plan is a defined-contribution plan. Employees are immediately eligible to make contributions to the plan and are also eligible for an employer contribution match at an amount equal to 100.0% of the first 4.0% of eligible employee contributions. Eligible plan participants may also receive an additional discretionary match from Nasdaq. There was no discretionary match for 2004, 2003 and 2002. Savings plan expense included in compensation and benefits expense in the Consolidated Statements of Income for the years ended December 31, 2004, 2003 and 2002, was \$3.1 million, \$3.4 million and \$1.8 million, respectively.

**15. Stock Compensation and Stock Awards**

Effective December 5, 2000, as amended on February 14, 2001 and January 23, 2002, Nasdaq adopted The Nasdaq Stock Market, Inc. Equity Incentive Plan (the "Plan"), under which nonqualified and qualified incentive stock options, restricted stock, restricted stock units, or other stock based awards may be granted to employees, directors, officers and consultants. A total of 24,500,000 shares are authorized under the Plan. At December 31, 2004, 7,550,992 shares were available for future grants under the Plan. In 2003, Nasdaq also issued stock options and restricted stock outside of the Plan.

In 2004, Nasdaq granted 6,068,800 stock options, 109,000 shares of restricted stock to employees and officers and 49,014 shares of restricted stock to non-employee Board of Directors members pursuant to the Plan. During 2004, 824,202 stock options and 59,947 shares of restricted stock awards were forfeited.

In December 2001, the Board adopted a revised Non-Employee Directors Compensation Policy whereby beginning in 2002 all non-employee directors were awarded 5,000 stock options per year with an exercise price at fair market value, which may be exercised for up to 10 years while serving on the Board of Directors (in general, three years from termination of service on the Board of Directors). On January 23, 2002, a total of 65,000 stock options were awarded to non-employee directors pursuant to the policy. Later in November 2002, the Board approved a modification to the Non-Employee Directors Compensation Policy whereby all non-employee directors will receive a compensation package valued at \$40,000. On April 28, 2004, the Board approved a modification to the Non-Employee Directors Compensation Policy whereby all non-employee directors would receive a base compensation package valued at \$50,000. Each non-employee director may elect to receive the base compensation package in cash, payable in equal quarterly installments, shares of restricted stock or a combination thereof. The shares of restricted stock will vest two years from the date of grant and unvested shares are forfeited in certain circumstances upon termination of the director's service on the Nasdaq Board. During 2004, 49,014 shares of restricted stock were awarded to non-employee directors. Directors who serve as committee chairs or as members of the Audit Committee and the chairman of the board are entitled to additional compensation beyond the base compensation package, however, these additional amounts are paid in cash rather than restricted stock.

Restricted stock awards are awarded in the name of the employee or officer at fair market value on the date of the grant. In 2004, Nasdaq granted 109,000 shares of restricted stock to employees and officers with a

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**Notes to Consolidated Financial Statements—(Continued)**

weighted-average grant price of \$7.45. Restricted stock awards contain restrictions on sales and transfers, are generally subject to a five-year vesting period and are expensed over the vesting period. Nasdaq recognized \$0.5 million and \$2.0 million in amortization expense related to restricted stock during the years ended December 31, 2004 and December 31, 2002, respectively. For the year ended December 31, 2003, the number of restricted stock awards forfeited more than offset the yearly amortization expense to a \$0.05 million benefit.

Stock options are granted with an exercise price equal to the fair market value of the stock on the date of the grant. Nasdaq accounts for stock option grants in accordance with APB 25, and, accordingly, recognizes no compensation expense related to such grants.

Options granted generally vest over three years and expire 10 years from the date of grant. Beginning in 2004, the Board approved the issuance of Performance Accelerated Stock Options ("PASO") and granted 4,919,000 PASOs during the year. The PASOs include a performance based accelerated vesting feature based on Nasdaq achieving specific levels of performance in fiscal years 2004 and 2005. The vestings of the PASO awards are no longer than six years from the grant date. All options to date have been granted at fair market value on the date of grant. At December 31, 2004, options for 8,368,901 shares were vested (including grants outside of the Plan), and exercisable with a weighted-average exercise price of \$11.92. At December 31, 2003, options for 7,550,589 shares were vested (including grants outside of the Plan), and exercisable with a weighted-average exercise price of \$12.43. The weighted-average remaining contract life was 7.6 years and 7.5 years at December 31, 2004 and 2003, respectively.

Stock option activity, including shares from outside of the Plan, during the year ended December 31, 2004 is set forth below:

	Shares	Price per Share	
		Range	Weighted Average
Balance, January 1, 2004		5.28 -	
	13,423,134	\$ \$19.70	\$ 10.82
Granted		6.15 -	
	6,068,800	\$ \$ 9.15	\$ 7.58
Exercised		5.28 -	
	310,296	\$ \$ 8.50	\$ 5.39
Canceled		6.15 -	
	2,124,875	\$ \$13.00	\$ 10.94
Balance, December 31, 2004		5.28 -	
	17,056,763	\$ \$19.70	\$ 9.75

The following table presents the options outstanding as of December 31, 2004 by ranges of exercise prices:

Range of Exercise Prices	Outstanding as of December 31, 2004	Weighted Average Exercise Price
\$ 5.28 - \$ 7.34	2,564,000	\$ 6.00
\$ 7.35 - \$ 8.49	3,987,500	\$ 7.37
\$ 8.50 - \$10.24	3,584,049	\$ 8.74
\$10.25 - \$12.99	186,284	\$ 10.39
\$13.00 - \$13.38	6,633,330	\$ 13.00
\$13.39 - \$19.69	—	—
\$19.70 - \$20.00	101,600	\$ 19.70
	<u>17,056,763</u>	<u>\$ 9.75</u>

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

Stock option activity during the year ended December 31, 2003 is set forth below:

	Shares	Price per Share	
		Range	Weighted Average
Balance, January 1, 2003	10,917,403	10.25 - \$ \$19.70	\$ 12.91
Granted	5,398,410	5.28 - \$ \$ 9.05	\$ 7.41
Exercised	—	—	—
Canceled	2,892,679	6.30 - \$ \$19.70	\$ 12.33
Balance, December 31, 2003	13,423,134	5.28 - \$ \$19.70	\$ 10.82

Nasdaq has an employee stock purchase plan for all eligible employees. Under the plan, shares of common stock may be purchased at six-month intervals (each, an "Offering Period") at 85.0% of the lower of the fair market value on the first or the last day of each Offering Period. Employees may purchase shares having a value not exceeding 10.0% of their annual compensation, subject to applicable annual Internal Revenue Service limitations. During 2004 and 2003, employees purchased an aggregate of 110,408 and 143,352 shares at a weighted-average price of \$5.45 and \$6.95 per share, respectively.

Pro forma information regarding net income and earnings per share is required under SFAS 148 and has been determined as if Nasdaq had accounted for all stock option grants based on a fair value method. The fair value of each stock option grant was estimated at the date of grant using the Black-Scholes valuation model assuming a weighted-average expected life of five years, weighted-average expected volatility of 30.0% and a weighted-average risk free interest rate of 3.43% and 2.94% for 2004 and 2003, respectively. The weighted-average fair value of options granted in 2004 and 2003 was \$2.49 and \$2.37, respectively.

Pro forma net income includes the amortization of the fair value of stock options over the vesting period and the difference between the fair value and the purchase price of common shares purchased by employees under the employee stock purchase plan. The pro forma net income also includes a reduction in option expense due to the true-up of actual forfeitures. The pro forma information for the years ended December 31, 2004 and December 31, 2003 is as follows:

	Year Ended December 31,	
	2004	2003
	(in thousands, except per share amounts)	
Reported net income (loss) from continuing operations	\$ 1,804	\$ (45,112)
Stock-based compensation cost (net of tax of \$2,541 and \$8,347, respectively)	(3,936)	(12,932)
Pro forma net loss	\$ (2,132)	\$ (58,044)
Reported basic and diluted loss per share	\$ (0.14)	\$ (0.68)
Pro forma basic and diluted loss per share	\$ (0.19)	\$ (0.85)

**16. Leases**

Nasdaq leases office space and equipment under non-cancelable operating leases with third parties and also subleases office space from NASD in New York City. Certain leases contain renewal options and escalation clauses based on increases in property taxes and building operating costs.

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

As of December 31, 2004, future minimum lease payments under non-cancelable operating leases (net of sublease income) are as follows:

	<u>Gross Lease Commitments</u>	<u>Sublease Income</u>	<u>Net Lease Commitments</u>
	(in thousands)		
Year ending December 31:			
2005	\$ 42,328	\$ 1,900	\$ 40,428
2006	27,890	2,185	25,705
2007	21,569	2,224	19,345
2008	16,260	2,299	13,961
2009	15,622	2,266	13,356
Remaining years	145,580	15,221	130,359
Total future minimum lease payments	<u>\$ 269,249</u>	<u>\$26,095</u>	<u>\$ 243,154</u>

Rent expense for operating leases (net of sublease income of \$0.4 million in 2004) was \$18.3 million, \$19.4 million and \$17.3 million for the years ended December 31, 2004, 2003 and 2002, respectively.

**17. Accumulated Other Comprehensive Income**

Comprehensive income is composed of net income and other comprehensive income, which includes the after-tax change in unrealized gains and losses on available-for-sale securities, foreign currency translation adjustments and a minimum pension liability adjustment.

The following table outlines the components of other comprehensive (loss) income:

	<u>Unrealized Gains (Losses)<sup>(1)</sup></u>	<u>Translation Adjustments<sup>(2)</sup></u>	<u>Minimum Pension Liability<sup>(3)</sup></u>	<u>Accumulated Other Comprehensive (Loss) Income</u>
	(in thousands)			
Balance, January 1, 2002	1,239	(6,820)	(1,395)	(6,976)
Net change	(2,048)	6,402 <sup>(4)</sup>	296	4,650
Balance, December 31, 2002	(809)	(418)	(1,099)	(2,326)
Net change	760	1,948 <sup>(5)</sup>	(296)	2,412
Balance, December 31, 2003	\$ (49)	\$ 1,530	\$ (1,395)	\$ 86
Net change	(920)	232	(454)	(1,142)
Balance, December 31, 2004	<u>\$ (969)</u>	<u>\$ 1,762</u>	<u>\$ (1,849)</u>	<u>\$ (1,056)</u>

(1) Primarily represents the after-tax difference between the fair value and cost (after recognition of \$0.6 million and \$0.7 million in an after tax other-than-temporary loss in 2003 and 2002, respectively) of the available-for-sale securities portfolio.

(2) Includes after-tax gains and losses on foreign currency translation from operations for which the functional currency is other than the U.S. dollar.

(3) Represents the after-tax adjustment to record the minimum pension liability for the SERP.

(4) Approximately \$2.4 million of foreign currency translation loss has been included in Nasdaq Japan impairment loss in the Consolidated Statements of Income. See "Nasdaq Japan," of Note 3, "Significant Transactions," for further discussion.

(5) Approximately \$1.7 million of foreign currency translation loss has been included in Net income (loss) from

discontinued operations, net of tax in the Consolidated Statements of Income. See "Strategic Review," of Note 3, "Significant Transactions," for further discussion.

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

**18. Segments**

Nasdaq manages, operates and provides its products and services in two business segments, our Market Services segment and our Issuer Services segment. The Market Services segment includes our transaction-based business (Nasdaq Market Center) and our market information services business (Nasdaq Market Services Subscriptions), which are interrelated because the transaction-based business generates the quote and trade information that we sell to market participants and data vendors. The Issuer Services segment includes our securities listings business (Corporate Client Group) and our financial products business (Nasdaq Financial Products). The companies listed on The Nasdaq Stock Market represent a diverse array of industries. This diversity of Nasdaq-listed companies allows us to develop industry-specific and other Nasdaq indices that we use to develop and license financial products and associated derivatives. Because of the foregoing interrelationships, our management allocates resources, assesses performance and manages these businesses as two separate segments. Prior to 2003, Nasdaq operated in one segment.

Nasdaq evaluates the performance of its segments based on several factors, of which the primary financial measure is pre-tax income. Results of individual businesses are presented based on Nasdaq's management accounting practices and Nasdaq's management structure. Certain charges are allocated to Corporate items in Nasdaq's management reports based on the decision that those activities should not be used to evaluate the segment's operating performance. These charges in 2003 and 2002 primarily include all activities and exit costs related to the elimination of Nasdaq's non-core product lines and other initiatives as well as Nasdaq Japan.

The following table presents certain information regarding these operating segments at December 31, 2004, 2003 and 2002 and for each of the years then ended.

	<u>Market Services</u>	<u>Issuer Services</u>	<u>Corporate Items and Eliminations</u>	<u>Consolidated</u>
	(in thousands)			
<b>2004</b>				
Revenues	\$ 334,517	\$ 205,821	\$ 103	\$ 540,441
Cost of revenues	(55,845)	—	—	(55,845)
Gross margin	<u>278,672</u>	<u>205,821</u>	<u>103</u>	<u>484,596</u>
Depreciation and amortization	58,441	17,438	457	76,336
Pre-tax (loss) income	(58,945) <sup>(1)</sup>	67,575	(6,077)	2,553
Assets <sup>(2)</sup>	435,534	87,240	292,046	814,820
Cash paid for property and equipment	22,306	3,650	73	26,029
<b>2003</b>				
Revenues	\$ 383,715	\$ 204,186	\$ 1,944	\$ 589,845
Depreciation and amortization	60,685	18,373	10,925	89,983
Pre-tax (loss) income	(4,534)	51,854	(113,672)	(66,352)
Assets <sup>(2)</sup>	250,810	127,688	472,756	851,254
Cash paid for property and equipment	23,555	5,543	2,497	31,595
<b>2002</b>				
Revenues	\$ 581,774	\$ 203,969	\$ 1,411	\$ 787,154
Depreciation and amortization	59,138	18,561	10,803	88,502
Pre-tax income (loss)	122,189	43,984	(60,231)	105,942
Assets <sup>(2)</sup>	394,625	193,693	587,596	1,175,914
Cash paid for property and equipment	54,670	11,396	9,087	75,153

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

- (1) Pre-tax loss due to a decrease in revenues. Also includes the majority of costs for regulatory services from NASDR and majority of technology costs due to the nature of operations of Market Services.
- (2) Includes continuing and discontinued operations for 2002. Corporate items also include the assets of Nasdaq's Treasury Department (primarily cash and cash equivalents and investments).

**Geographic Data**

The following table presents revenues and property and equipment, net by geographic area for 2004, 2003 and 2002. Revenues are classified based upon the location of the customer. Property and equipment information is based on the physical location of the assets.

	Revenues	Property and Equipment, Net
	(in thousands)	
<b>2004:</b>		
United States	\$494,132	\$ 173,083
All other countries	46,309	757
Total	<u>\$540,441</u>	<u>\$ 173,840</u>
<b>2003:</b>		
United States	\$534,450	\$ 242,672
All other countries	55,395	271
Total	<u>\$589,845</u>	<u>\$ 242,943</u>
<b>2002:</b>		
United States	\$714,741	\$ 327,937
All other countries	72,413	753
Total	<u>\$787,154</u>	<u>\$ 328,690</u>

In 2004, 2003 and 2002, no single customer accounted for 10.0% or more of Nasdaq's revenues.

**19. Commitments and Contingencies****Brut Agreements**

Brut contracted with a subsidiary of SunGard, SunGard Financial, for SunGard Financial to provide Brut on-line processing, report services and related services in connection with the clearance of trades. The term of the agreement is five years beginning in September 2004 and is automatically renewed at yearly intervals thereafter until terminated by Brut or SunGard Financial. The annual service fee is \$10.0 million in the first year, dropping to \$8.0 million in the second year and \$6.0 million in the third year of the agreement. The annual service fee is subject to price review in years four and five based market rates, but will not be less than \$4.0 million per year. Some additional fees may be assessed based on services needed or requested.

Brut also contracted with SunGard to host certain software on designated equipment at a SunGard facility for a transitional period beginning in September 2004. SunGard developed and operated the computer software programs that enables Brut to operate and provide order entry and execution over its ECN. Under the terms of the original agreement, which began in September 2004 through May 2005, Brut was obligated to pay SunGard approximately \$0.1 million per month. On November 29, 2004, an amendment was signed which extended the original agreement through June 30, 2006 and beginning November 30, 2005, Brut may cancel the agreement within 30 days written notice to SunGard.

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements—(Continued)***Brokerage Activities*

Brut provides guarantees to securities clearinghouses and exchanges under their standard membership agreements, which require members to guarantee the performance of other members. If a member becomes unable to satisfy its obligations to the clearinghouses, other members would be required to meet its shortfalls. To mitigate these performance risks, the exchanges and clearinghouses often require members to post collateral as well as meet certain minimum financial standards. Brut's maximum potential liability under these arrangements cannot be quantified. However, Nasdaq believes that the potential for Brut to be required to make payments under these arrangements is unlikely. Accordingly, no contingent liability is recorded in the Consolidated Balance Sheets for these arrangements.

*Nasdaq Insurance Agency*

In December 2002, Nasdaq purchased NASD's 50.0% interest in NASD Insurance Agency (subsequently renamed the Nasdaq Insurance Agency, LLC). Nasdaq's consideration for NASD's 50.0% interest consisted of an upfront payment of \$0.5 million and up to \$5.1 million based on NIA's stream of contingent cash flow through 2016 (which reflects an agreement in 2004 between Nasdaq and NASD to extend the term from 2011 to 2016). Nasdaq will pay NASD up to: (a) 20% of NIA's cash flows until Nasdaq has paid NASD \$2.3 million from cash flows; (b) 10% of NIA's cash flows until Nasdaq has paid NASD a cumulative amount of \$3.0 million from cash flows; (c) 5% of NIA's cash flows until the earlier to occur of Nasdaq paying NASD the full cumulative amount of \$5.1 million from cash flows or December 31, 2016. As of December 31, 2004, Nasdaq recorded a \$0.4 million dividend to NASD for the NIA's cash flows. The dividend was reflected as a reduction in additional paid-in capital on Nasdaq's Consolidated Balance Sheets.

On January 1, 2005, Nasdaq purchased the remaining 50.0% interest in the NIA from AIG NJV, Inc. for nominal consideration. On December 31, 2004, Nasdaq entered into a revolving promissory note with the NIA and loaned the agency \$2.9 million, which is included in receivables from related parties on the Consolidated Balance Sheets. See Note 23, "Subsequent Events," for further discussion.

*MCI*

On January 30, 2004, Nasdaq and MCI entered into a global services agreement, effective May 31, 2004, related to the data network that connects Nasdaq's market facilities to market participants. The GSA terminated the prior agreement between the two parties. The GSA, which expires on December 31, 2005, requires usage charges for certain GSA services to be at least \$20.0 million during the period from June 1, 2004 to December 31, 2004 and \$20.0 million in 2005. In 2004, Nasdaq met the minimum usage charges and fully expects to meet the minimum usage charges in 2005.

*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. Future minimum lease payments, net of sublease income of \$26.1 million, at December 31, 2004 were \$243.1 million (including \$38.9 million for equipment) over the life of the leases. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations," Contractual Obligations and Contingent Commitments, for further discussion.

In October 2004, Nasdaq entered into a lease agreement for technology equipment and also renegotiated related operating leases with a major vendor. Nasdaq also upgraded related leased equipment and entered into a

Table of Contents**The Nasdaq Stock Market, Inc.****Notes to Consolidated Financial Statements—(Continued)**

new three year operating lease and extended the terms of license and maintenance agreements. Under the terms of these leases and license and maintenance agreements, Nasdaq will pay a total of \$36.2 million, over the remaining lives of the leases and agreements. See “2004 Cost Reductions,” of Note 3, “Significant Transactions,” for further discussion.

*General Litigation*

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

**20. Related Party Transactions**

Related party receivables and payables are the result of various transactions between Nasdaq and its affiliates. Receivables from related parties relate to cash disbursements and loans funded by us on behalf of our affiliates. Payables to related parties are comprised primarily of the regulation charge from NASDR, a wholly-owned subsidiary of NASD. NASDR charges Nasdaq for costs incurred related to Nasdaq market regulation and enforcement.

**Surveillance and Other Regulatory Charges from NASDR**

NASDR currently provides us with regulatory services, including the regulation of trading activity on The Nasdaq Stock Market and over-the-counter market and market surveillance functions of Nasdaq. NASDR charges Nasdaq for these services based upon NASD management’s estimated percentage of costs incurred by each NASDR department that are attributable directly to The Nasdaq Stock Market. The following table represents the composition of costs charged by NASDR to Nasdaq:

	Year Ended December 31,		
	2004	2003	2002
		(in thousands)	
Compensation and benefits	\$17,887	\$19,783	\$24,418
Professional and contract services	11,932	17,364	24,038
Occupancy	1,096	2,534	3,202
Computer operations and data communications	3,455	2,953	4,570
Depreciation	9,377	18,120	15,481
General and administrative	1,841	1,092	4,999
Total	<u>\$45,588</u>	<u>\$61,846</u>	<u>\$76,708</u>

Regulatory charges from NASDR were \$45.6 million, \$61.8 million and \$76.7 million for the years ended December 31, 2004, 2003 and 2002, respectively. These costs have decreased primarily due to NASD’s careful review of NASDR charges and the allocation of these charges among the markets and members it regulates. Lower expenses in 2004 compared to 2003 also relate to lower depreciation charges as certain technology assets were fully depreciated during the year ended December 31, 2003. The ongoing review of these charges and related services will continue and may result in further reductions in these costs in 2005 without effecting the quality of regulatory oversight.

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

**Support Costs from NASD**

During 2003 and 2002, NASD provided certain administrative, corporate and infrastructure services to Nasdaq. It was NASD's policy to charge these expenses and other operating costs to Nasdaq based upon usage percentages determined by management of NASD and Nasdaq. Additionally, NASD incurred certain costs related to the development and maintenance of technology for Nasdaq. Technology development costs were allocated directly to Nasdaq based upon specific projects requested by Nasdaq. Technology maintenance costs were allocated based upon Nasdaq's share of computer usage. The services provided by NASD have declined in recent years and were minimal in 2004. Support costs from NASD were \$1.2 million and \$5.1 million for the years ended December 31, 2003 and 2002, respectively. The decrease was due to continued progress in separating from NASD and the resulting internalization of technology and certain other support functions. The following table represents the composition of costs charged by NASD to Nasdaq:

	Year Ended December 31,	
	2003	2002
	(in thousands)	
Compensation and benefits	\$ 491	\$ 1,689
Professional and contract services	316	1,236
Occupancy	91	877
Computer operations and data communications	77	251
Depreciation	91	344
General and administrative	118	730
Total	<u>\$ 1,184</u>	<u>\$ 5,127</u>

**Nasdaq Charge to Amex**

During 2003 and 2002, Nasdaq incurred technology costs on behalf of Amex related to development of new Amex systems and enhancement of existing Amex systems. Amounts were charged based upon specific projects requested by Amex. The amounts charged from Nasdaq to Amex were minimal for the year ended December 31, 2004. Amounts charged from Nasdaq to Amex are included in support costs from related parties, net and are summarized as follows:

	Year Ended December 31,	
	2003	2002
	(in thousands)	
Compensation and benefits	\$ 283	\$ 509
Professional and contract services	1,045	6,011
General and administrative	198	347
Total	<u>\$ 1,526</u>	<u>\$ 6,867</u>

During 2001, Nasdaq agreed to fund a portion of the necessary expenses related to the separation of software, hardware and data under a plan to transition technology applications and support from Nasdaq to Amex. NASD originally integrated certain Nasdaq and Amex technology subsequent to the 1998 acquisition of Amex by NASD. The total estimated cost of the separation had been established at a maximum of \$29.0 million, and was to be shared evenly between Nasdaq and NASD. In 2002 and 2001, Nasdaq accrued \$5.3 million and \$9.2 million, respectively under this commitment, fulfilling its commitment. As of December 31, 2003, \$9.5 million had been paid to Amex. The remaining commitment was paid by the end of the second quarter of 2004.

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**Table of Contents****The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

Effective January 1, 2005, Amex was sold back to its members by NASD and is no longer considered a related party of Nasdaq.

**21. Capital Stock**

At December 31, 2004, 300,000,000 shares of Nasdaq's common stock were authorized, 130,653,191 shares were issued and 78,973,085 shares were outstanding. Each share of common stock has one vote, except that our certificate of Incorporation limits the ability of any person to vote in excess of 5.0% of the then-outstanding voting interest of Nasdaq. This limitation does not apply to NASD or other persons exempted from this limitation by our board of directors prior to the time such person owns more than 5.0% of the then-outstanding voting interest of Nasdaq.

In 2000, NASD implemented a separation of Nasdaq from NASD by restructuring and broadening the ownership in Nasdaq through a two-phase private placement of securities. In the private placements, (i) NASD sold (a) an aggregate of 10,806,494 warrants to purchase an aggregate amount of 43,225,976 shares of outstanding common stock of Nasdaq and (b) 4,543,591 shares of outstanding common stock and (ii) Nasdaq sold an aggregate of 28,692,543 newly-issued shares of common stock to investors. Securities in the private placements were offered to all NASD members, certain issuers listed on The Nasdaq Stock Market and certain investment companies. Each warrant issued by NASD entitles the holder to purchase one share in each of four one-year exercise periods. NASD is currently in the third exercise period, expiring June 28, 2005, which the exercise price per share is \$15.00. The voting rights associated with the shares of common stock underlying the warrants, as well as the shares of common stock purchased through the valid exercise of warrants, are governed by the voting trust agreement (the "Voting Trust Agreement") entered into by NASD, Nasdaq and The Bank of New York, as voting trustee (the "Voting Trustee"). Currently, the holders of the warrants (each, a "Warrant Holder" and, collectively, the "Warrant Holders") do not have any voting rights with respect to the shares of common stock underlying such warrants. Until exchange registration the shares of common stock underlying unexercised and unexpired warrant tranches, as well as the shares of common stock purchased through the exercise of warrants, will be voted by the Voting Trustee at the direction of NASD. The voting rights associated with the shares of common stock underlying unexercised and expired warrant tranches will revert to NASD. However, NASD previously indicated that commencing upon exchange registration, it will vote any shares of common stock that it owns (other than shares underlying then outstanding warrants) in the same proportion as the other stockholders of Nasdaq. Upon exchange registration, the Warrant Holders will have the right to direct the Voting Trustee as to the voting of the shares of common stock underlying unexercised and unexpired warrant tranches until the earlier of the exercise or the expiration of such warrant tranches. The shares of common stock purchased upon a valid exercise of a warrant tranche prior to exchange registration will be released from the Voting Trust Agreement upon exchange registration. The shares of common stock purchased upon a valid exercise of a warrant tranche after exchange registration will not be subject to the Voting Trust Agreement. On February 15, 2005, NASD sold 16,586,980 shares of common stock underlying warrants that had expired unexercised in an underwritten public offering. See Note 23, "Subsequent Events." As a result, as of February 15, 2005, NASD owns 26,596,416 million shares of Nasdaq's common stock, including shares of common stock underlying unexpired and unexercised warrants.

As part of the Restructuring, Nasdaq repurchased a total of 52,230,433 shares of common stock from NASD during 2001 and 2002 (the "Repurchase"). Nasdaq purchased the common stock for approximately \$305.2 million in aggregate cash consideration, 1,338,402 shares of Nasdaq's Series A Cumulative Preferred Stock (face and liquidation value of \$100 per share, plus any accumulated unpaid dividends) and one share of Nasdaq's Series B Preferred Stock, (face and liquidation value of \$1.00 per share). On November 29, 2004, Nasdaq entered into an exchange agreement with NASD pursuant to which NASD exchanged 1,338,402 shares of Series A Preferred Stock, representing all the outstanding shares of Series A Cumulative Preferred Stock, for 1,388,402

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

shares of newly issued Series C Cumulative Preferred Stock (face and liquidation value of \$100 per share, plus any accumulated and unpaid dividends). The Series C Cumulative Preferred Stock accrues quarterly dividends at an annual rate of 3.0% for all periods until July 1, 2006 and at an annual rate of 10.6% for periods thereafter, payable at the discretion of our board of directors. Holders of the Series C Cumulative Preferred Stock also may be entitled to an additional payment in certain circumstances depending on the amount of time the Series C Cumulative Preferred Stock is outstanding and the market price of our common stock at the time Nasdaq redeems the Series C Cumulative Preferred Stock. NASD owns all of the outstanding shares of Series B and Series C Cumulative Preferred Stock. All of the shares of common stock repurchased by Nasdaq from NASD are no longer outstanding and are held in common stock in treasury. As of December 31, 2004, there were 30,000,000 shares of preferred stock authorized, 1,338,402 Series C Cumulative Preferred Stock and one share of Series B Preferred Stock issued and outstanding.

Shares of Series C Cumulative Preferred Stock do not have voting rights, except for the right as a class to elect two new directors to Nasdaq's board of directors at such time as distributions on the Series C Cumulative Preferred Stock are in arrears for four consecutive quarters. Nasdaq may redeem the shares of Series C Cumulative Preferred Stock at any time after exchange registration and are required to use the net proceeds from an offering for cash of Nasdaq's common stock by Nasdaq, subject to certain limited exceptions, to redeem all or a portion of the Series C Cumulative Preferred Stock.

The Series B Preferred Stock does not pay dividends. NASD, as holder of the one share of the Series B Preferred Stock, will be entitled to cast the number of votes that, together with all other votes that NASD is entitled to vote by virtue of ownership, proxies or voting trusts, enables NASD to cast one vote more than one-half of all votes entitled to be cast by stockholders of Nasdaq. If Nasdaq obtains Exchange Registration, the share of Series B Preferred Stock will automatically lose its voting rights and will be redeemed by Nasdaq. In addition to the voting rights of the common stock and Series B Preferred Stock, the holders of the Subordinated Notes have certain voting rights as discussed in Note 12, "Subordinated Notes."

In connection with the repurchase of ownership interest of a shareholder in Nasdaq Europe Planning in 2001, Nasdaq issued a warrant to purchase up to an aggregate of 479,648 shares of common stock. The warrant is exercisable in four annual tranches ranging from \$13.00 to \$16.00 per share beginning June 28, 2002. The issuance of the warrants has been recorded at fair value in stockholders' equity. As of December 31, 2004, the warrant is still outstanding and no tranches have been exercised; however two of the tranches have expired unexercised.

## **22. Earnings Per Common Share**

Earnings per common share is computed in accordance with SFAS No. 128, "Earnings Per Share" ("SFAS 128"). Basic earnings per share excludes the dilutive effects of options, awards, warrants and convertible securities, and is calculated by dividing net income available to common stock holders by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflects all potentially dilutive securities.

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**The Nasdaq Stock Market, Inc.**  
**Notes to Consolidated Financial Statements—(Continued)**

The following table sets forth the computation of basic and diluted (loss) earnings per share:

	Year Ended December 31,		
	2004	2003	2002
	(in thousands, except share and per share amounts)		
<b>Numerator:</b>			
<b>Net income (loss) applicable to common stockholders:</b>			
Net income (loss)	\$ 11,362	\$ (105,447)	\$ 43,128
Net income (loss) from discontinued operations	9,558	(60,335)	(21,893)
Net income (loss) from continuing operations	1,804	(45,112)	65,021
Preferred Stock:			
Loss on exchange of securities	(3,908)	—	—
Dividends declared	(8,354)	(8,279)	—
Accretion of preferred stock	(926)	—	(9,765)
Net (loss) income applicable to common stockholders from continuing operations for basic and diluted earnings per share	\$ (11,384)	\$ (53,391)	\$ 55,256
Net income (loss) from discontinued operations for basic and diluted earnings per share	9,558	(60,335)	(21,893)
Net (loss) income available to common stockholders for basic and diluted earnings per share	\$ (1,826)	\$ (113,726)	\$ 33,363
<b>Denominator:</b>			
Weighted average common shares for basic earnings per share	78,607,126	78,378,376	83,650,478
Weighted average effect of dilutive securities:			
Warrants	—	—	1,417
Employee stock options and awards	—	—	421,486
Denominator for diluted earnings per share	78,607,126	78,378,376	84,073,381
<b>Basic and diluted net (loss) earnings per share:</b>			
Continuing operations	\$ (0.14)	\$ (0.68)	\$ 0.66
Discontinued operations	0.12	(0.77)	(0.26)
Total basic and diluted net (loss) earnings per share	\$ (0.02)	\$ (1.45)	\$ 0.40

Options to purchase 17,056,763 shares of common stock, 306,662 shares of restricted stock, 12,000,000 shares underlying Subordinated Notes and 239,834 shares underlying warrants were outstanding during 2004, but were not included in the computation of earnings per share as their inclusion would be antidilutive.

Options to purchase 13,423,134 shares of common stock, 286,365 shares of restricted stock, 12,000,000 shares underlying Subordinated Notes and 359,736 shares underlying warrants were outstanding during 2003, but were not included in the computation of earnings per share as their inclusion would be antidilutive.

Options to purchase 10,917,403 shares of common stock, 382,190 shares of restricted stock, 12,000,000 shares underlying Subordinated Notes and 479,648 shares underlying warrants were outstanding during 2002. For the year ended December 31, 2002, 10,709,423 of the options outstanding, all of the shares of restricted stock and 119,912 of the shares underlying the warrants were included in the computation of diluted earnings per share, on a weighted average basis, as their

inclusion was dilutive. The remaining options, remaining shares underlying the warrants issued by Nasdaq and the 12,000,000 shares underlying Subordinated Notes outstanding during 2002, were considered antidilutive and were properly excluded.

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**Table of Contents****The Nasdaq Stock Market, Inc.  
Notes to Consolidated Financial Statements—(Continued)****23. Subsequent Events***Purchase of NIA*

On January 1, 2005, Nasdaq purchased the remaining 50.0% interest in the Nasdaq Insurance Agency from AIG NJV, Inc. for nominal consideration. The purchase is not expected to have any impact on the operations of the agency. Beginning January 1, 2005, Nasdaq will consolidate the Insurance Agency in its consolidated results.

*Common Stock Listing*

Nasdaq applied for and was granted a common stock listing on The Nasdaq National Market, and commenced trading on The National Market under the symbol NDAQ on February 10, 2005.

*Completion of Secondary Offering*

On February 15, 2005, Nasdaq completed an underwritten secondary offering of 16,586,980 shares of common stock owned by NASD and an additional 3,246,536 shares of common stock owned by certain selling stockholders who purchased the shares in Nasdaq's private placements in 2000 and 2001. Nasdaq, its officers or other employees did not sell any shares in the secondary offering and Nasdaq did not receive any proceeds from the offering.

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**The Nasdaq Stock Market, Inc.**  
**Schedule II—Valuation and Qualifying Accounts**  
**Three Years Ended December 31, 2004**  
**(in thousands)**

	<u>Reserve for Bad Debts</u>		
	<u>2004</u>	<u>2003</u>	<u>2002</u>
Balance at beginning of period	\$ 1,692	\$ 5,890	\$ 7,437
Additions:			
Charges to income	1,074	1,365	8,426
Recoveries of amounts previously written-off	792	107	—
Acquisition of Brut	1,240	—	—
Deductions:			
Charges for which reserves were provided	(1,640)	(5,670)	(9,973)
Balance at end of period	<u>\$ 3,158</u>	<u>\$ 1,692</u>	<u>\$ 5,890</u>

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