

NASDAQ STOCK MARKET INC
Form 10-Q
August 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2006

OR

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

For the transition period from _____ to _____

Commission file number 0-32651

THE NASDAQ STOCK MARKET, INC.

(Exact Name of Registrant as Specified in Its Charter)

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Delaware
(State or Other Jurisdiction of

52-1165937
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

One Liberty Plaza New York, New York
(Address of Principal Executive Offices)

10006
(Zip Code)

(212) 401-8700

(Registrant's Telephone Number, Including Area Code)

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

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

Large accelerated filer ☒ Accelerated filer ☐ Non-accelerated filer ☐

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at July 31, 2006
Common stock, \$0.01 par value per share	111,655,532 shares

The Nasdaq Stock Market, Inc.

Form 10-Q

For the Quarterly Period Ended June 30, 2006

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This Quarterly Report on Form 10-Q includes market share and industry data that we obtained from industry publications and surveys, reports of governmental agencies, and internal company surveys. Industry publications and surveys generally state that the information they contain has been obtained from sources believed to be reliable, but we cannot assure you that the information is accurate or complete. We have not independently verified any of the data from third-party sources nor have we ascertained the underlying economic assumptions relied upon therein. Statements as to our market position are based on most currently available market data. For market comparison purposes, data in this Quarterly Report on Form 10-Q for initial public offerings, or IPOs, of companies in the United States is based on data provided by Thomson Financial, which does not include best efforts underwritings and we have chosen to exclude closed-end funds, therefore, the data may not be comparable to other publicly-available initial public offering data. Data in this Quarterly Report on Form 10-Q for secondary offerings is also based on data provided by Thomson Financial. Data in this Quarterly Report on Form 10-Q for new listings of equity securities on The Nasdaq Stock Market is based on data generated internally by us, which includes best efforts underwritings and issuers that switched from other listing venues. While we are not aware of any misstatements regarding industry data presented herein, our estimates involve risks and uncertainties and are subject to change based on various factors, including those discussed in Item 1A. Risk Factors, in our Form 10-Q for the quarter ended March 31, 2006 and Item 1. Business Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2005.

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Forward-Looking Statements

The SEC encourages companies to disclose forward-looking information so that investors can better understand a company's future prospects and make informed investment decisions. This Quarterly Report on Form 10-Q contains these types of statements. Words such as anticipates, estimates, expects, projects, intends, plans, believes and words or terms of similar substance used in connection with any discussion of future operating results or financial performance identify forward-looking statements.

Forward-looking statements involve risks and uncertainties. Factors that could cause actual results to differ materially from those contemplated by the forward-looking statements include, among others, the following:

our operating results may be lower than expected;

our ability to implement our strategic initiatives and any consequences from our pursuit of our corporate strategy, including our integration of INET and our acquisition of an approximate 25.3% stake in the London Stock Exchange Group plc;

competition, economic, political and market conditions and fluctuations, including interest rate risk;

government and industry regulation; and

adverse changes that may occur in the securities markets generally.

Most of these factors are difficult to predict accurately and are generally beyond our control. You should consider the uncertainty and any risk related to forward-looking statements that we make. These risk factors are more fully described under the caption "Item 1A. Risk Factors," in our Form 10-Q for the quarter ended March 31, 2006 and "Item 1. Business-Risk Factors," in our Annual Report on Form 10-K for the year ended December 31, 2005. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date of this

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report. You should carefully read this entire Form 10-Q, including Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, and the Condensed Consolidated Financial Statements and the related notes. Except as required by the federal securities laws, we undertake no obligation to release publicly any revisions to any forward-looking statements, to report events or to report the occurrence of unanticipated events. For any forward-looking statements contained in any document, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

The Nasdaq Stock Market, Inc.

PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

The Nasdaq Stock Market, Inc.

Condensed Consolidated Statements of Income

(Unaudited)

(in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
Revenues				
Market Services	\$ 347,587	\$ 163,626	\$ 684,888	\$ 288,741
Issuer Services	63,380	56,060	122,258	110,965
Other	65		332	173
Total revenues	411,032	219,686	807,478	399,879
Cost of revenues				
Liquidity rebates	(170,633)	(69,180)	(337,831)	(104,555)
Brokerage, clearance and exchange fees	(69,248)	(20,045)	(136,479)	(38,585)
Total cost of revenues	(239,881)	(89,225)	(474,310)	(143,140)
Gross margin	171,151	130,461	333,168	256,739
Expenses				
Compensation and benefits	48,018	36,902	96,886	74,214
Marketing and advertising	3,820	2,026	8,851	3,372
Depreciation and amortization	21,471	14,933	46,019	33,126
Professional and contract services	7,299	6,972	16,202	14,023
Computer operations and data communications	10,264	15,945	20,216	32,104
Provision for bad debts	1,843	(745)	1,892	(174)
Occupancy	8,208	7,082	16,185	14,159
General and administrative	24,793	10,582	31,555	16,022
Total direct expenses	125,716	93,697	237,806	186,846
Support costs from related parties, net	9,105	10,441	17,222	20,812

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Total expenses	134,821	104,138	255,028	207,658
Operating income	36,330	26,323	78,140	49,081
Interest income	6,275	3,097	10,753	4,522
Interest expense	(24,406)	(4,634)	(40,850)	(7,496)
Dividend income	9,223		9,223	
Minority interest	317		453	
Income before income taxes	27,739	24,786	57,719	46,107
Income tax provision	11,095	10,815	23,087	19,365
Net income	\$ 16,644	\$ 13,971	\$ 34,632	\$ 26,742
Net income applicable to common stockholders:				
Net income	\$ 16,644	\$ 13,971	\$ 34,632	\$ 26,742
Preferred stock:				
Dividends declared		(785)	(359)	(1,790)
Accretion of preferred stock		(1,459)	(331)	(2,387)
Net income applicable to common stockholders	\$ 16,644	\$ 11,727	\$ 33,942	\$ 22,565
Basic and diluted earnings per share:				
Basic	\$ 0.16	\$ 0.15	\$ 0.35	\$ 0.28
Diluted	\$ 0.13	\$ 0.13	\$ 0.28	\$ 0.26

See accompanying notes to the condensed consolidated financial statements.

The Nasdaq Stock Market, Inc.

Condensed Consolidated Balance Sheets

(in thousands, except share and par value amounts)

	June 30, 2006	December 31, 2005
	(Unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 488,817	\$ 165,237
Available-for-sale investments, at fair value	1,215,525	179,369
Accounts receivable, net	234,395	207,632
Receivables from related parties	90	18
Deferred tax assets	14,324	9,953
Other current assets	35,537	34,754
Total current assets	1,988,688	596,963
Property and equipment:		
Land, buildings and improvements	31,649	60,920
Data processing equipment and software	180,583	179,991
Furniture, equipment and leasehold improvements	104,977	115,551
	317,209	356,462
Less accumulated depreciation and amortization	(222,904)	(233,886)
Total property and equipment, net	94,305	122,576
Non-current deferred tax assets	124,267	133,336
Goodwill	988,277	961,893
Intangible assets, net	207,251	215,478
Other assets	12,446	16,540
Total assets	\$ 3,415,234	\$ 2,046,786
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	\$ 112,092	\$ 118,884
Accrued personnel costs	36,166	55,284
Deferred revenue	114,869	53,593
Other accrued liabilities	56,456	61,849
Current portion of debt obligations	11,848	7,500
Payables to related parties	9,798	28,218
Total current liabilities	341,229	325,328
Debt obligations	1,612,565	1,184,928
Accrued pension costs	24,641	25,841
Non-current deferred tax liabilities	89,221	95,151
Non-current deferred revenue	98,618	92,019
Other liabilities	69,624	69,514
Total liabilities	2,235,898	1,792,781
Minority interest	545	998
Stockholders' equity		
Common stock, \$0.01 par value, 300,000,000 shares authorized, shares issued: 130,708,873 at June 30, 2006 and 130,684,783 at December 31, 2005; shares outstanding: 111,620,480 at June 30, 2006 and 83,148,909 at December 31, 2005	1,308	1,307

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Preferred stock, 30,000,000 shares authorized, Series D preferred stock: \$1.00 par value, 1 share issued and outstanding at June 30, 2006 and December 31, 2005; Series C Cumulative preferred stock: 953,470 shares issued and outstanding at December 31, 2005			95,017
Additional paid-in capital	1,039,229		383,669
Common stock in treasury, at cost: 19,088,393 shares at June 30, 2006 and 47,535,874 shares at December 31, 2005	(249,594)		(613,369)
Accumulated other comprehensive loss	(31,888)		(1,290)
Deferred stock compensation			(4,930)
Common stock issuable			6,809
Retained earnings	419,736		385,794
	<hr/>		<hr/>
Total stockholders' equity	1,178,791		253,007
	<hr/>		<hr/>
Total liabilities, minority interest and stockholders' equity	\$ 3,415,234		\$ 2,046,786
	<hr/>		<hr/>

See accompanying notes to the condensed consolidated financial statements.

The Nasdaq Stock Market, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(in thousands)

	Six Months Ended	
	June 30,	
	2006	2005
Reconciliation of net income to cash provided by operating activities		
Net income	\$ 34,632	\$ 26,742
Non-cash items included in net income:		
Depreciation and amortization expense	46,019	33,126
Share-based compensation expense	5,444	780
Income tax benefit related to share-based compensation	(18,991)	(2,802)
Provision for bad debts	1,892	(174)
Loss on the early extinguishment and refinancing of debt obligations	20,884	7,393
Deferred taxes, net	(1,351)	(1,728)
Loss on write down of assets held-for-sale	5,407	
Foreign currency gain related to investment in the LSE	(8,197)	
Other non-cash items included in net income	913	2,240
Net change in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	(3,561)	(27)
Receivables from related parties	(72)	3,210
Other assets	(13,065)	(12,763)
Accounts payable and accrued expenses	(4,534)	2,262
Accrued personnel costs	(19,486)	(21,479)
Deferred revenue	66,091	60,137
Other accrued liabilities	(13,761)	(3,320)
Payables to related parties	(9,068)	(1,102)
Accrued pension costs	(1,200)	3,359
Other liabilities	(710)	(853)
Cash provided by operating activities	87,286	95,001
Cash flow from investing activities		
Proceeds from redemptions of available-for-sale investments	392,395	209,655
Purchases of available-for-sale investments, net of capital return from the LSE	(1,479,786)	(265,064)
Proceeds from the maturities of available-for-sale investments	28,750	13,100
Proceeds from maturities of held-to-maturity investments		3,000
Purchases of held-to-maturity investments		(2,984)
Acquisitions of businesses, net of cash and cash equivalents acquired	(38,060)	3,063
Purchases of property and equipment	(5,989)	(9,032)
Proceeds from sales of property and equipment	298	17,974
Cash used in investing activities	(1,102,392)	(30,288)
Cash flow from financing activities		
Proceeds from debt obligations	1,850,000	205,000
Payments of debt obligations	(1,418,204)	
Net proceeds from equity offerings	972,719	

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Series C Cumulative preferred stock redemptions and dividends	(105,059)	(40,354)
Issuances of common stock, net of treasury stock purchases	20,239	16,741
Income tax benefit related to share-based compensation	18,991	
	<hr/>	<hr/>
Cash provided by financing activities	1,338,686	181,387
Increase in cash and cash equivalents	323,580	246,100
	<hr/>	<hr/>
Cash and cash equivalents at beginning of period	165,237	58,186
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$ 488,817	\$ 304,286
	<hr/>	<hr/>

See accompanying notes to the condensed consolidated financial statements.

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements

1. Basis of Presentation

Our unaudited condensed consolidated financial statements include the consolidated accounts of The Nasdaq Stock Market, Inc. Unless otherwise noted in this Quarterly Report on Form 10-Q, the terms Nasdaq, we, us and our refer to The Nasdaq Stock Market, Inc. and its wholly-owned subsidiaries. We are responsible for the unaudited condensed consolidated financial statements included in this document. In the opinion of management, all adjustments, consisting of normal recurring adjustments, necessary for a fair presentation, have been reflected. Revenues, expenses, assets and liabilities can vary during each quarter of the year. Therefore, the results and trends in these interim financial statements may not be representative of those for the full year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2005.

We have condensed or omitted footnotes or other financial information that are normally included in annual financial statements prepared in accordance with accounting principles generally accepted in the United States of America, or GAAP, but are not required for interim reports. Certain reclassifications have been made to prior year amounts to conform to the current year's presentation.

2. Recently Adopted Accounting Pronouncement

On January 1, 2006, we adopted Statement of Financial Accounting Standards, or SFAS, No. 123 (revised 2004), Share-Based Payment, or SFAS 123(R), which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees including employee stock options, restricted stock and certain employee stock purchase plans, based on estimated fair values. SFAS 123(R) supersedes our previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, or APB 25. In March 2005, the SEC issued Staff Accounting Bulletin No. 107, or SAB 107, relating to SFAS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

We adopted SFAS 123(R) using the modified prospective transition method and have recognized share-based compensation cost in the consolidated financial statements as of and for the three and six months ended June 30, 2006. We recognize compensation expense for share-based awards on a straight-line basis over the requisite service period of the award. In accordance with the modified prospective transition method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). We recognized share-based compensation expense of \$2.7 million under SFAS 123(R) for the three months ended June 30, 2006 and \$5.4 million for the six months ended June 30, 2006 and included these amounts in compensation and benefits expense in the Condensed Consolidated Statements of Income. We recognized share-based compensation expense of \$0.5 million for the three months ended June 30, 2005 and \$0.8 million for the six months ended June 30, 2005, which was related to restricted stock awards we had been expensing under previous accounting standards. We did not recognize any share-based compensation expense related to employee stock options during the three and six months ended June 30, 2005. See Note 10, Share-Based Compensation, for further discussion.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the consolidated statements of income. Prior to the adoption of SFAS 123(R), we accounted for share-based awards using the intrinsic value method

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in accordance with APB 25 as allowed under SFAS No. 123, Accounting for Share-Based Compensation, or SFAS 123. Under the intrinsic value method, we did not recognize any share-based compensation expense, other than as related to restricted stock awards, because the exercise price of our stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

Share-based compensation expense recognized during the period is based on the value of the portion of share-based awards that is ultimately expected to vest. Share-based compensation expense recognized in the Condensed Consolidated Statements of Income for the three and six months ended June 30, 2006 included compensation expense for share-based payment awards granted before, but not yet vested as of January 1, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted after January 1, 2006 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). We based our share-based compensation expense for the three and six months ended June 30, 2006 on awards that we expect to ultimately vest, reduced for estimated forfeitures. SFAS 123(R) requires us to estimate forfeitures at the time of grant and revise our estimate, if necessary, in subsequent periods if actual forfeitures differ from our estimates. In our pro forma information required under SFAS 123 for the periods before January 1, 2006, we accounted for forfeitures as required under SFAS 123(R).

On November 10, 2005, the Financial Accounting Standards Board, or FASB, issued FASB Staff Position No. FAS 123(R)-3 Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. We elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS 123(R). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool, or APIC pool, related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC pool and Condensed Consolidated Statements of Cash Flows of the tax effects of employee share-based compensation awards that are outstanding upon adoption of SFAS 123(R).

3. Business Combinations**Purchase Acquisition Shareholder.com**

In February 2006, we acquired Shareholder.com, a privately held, Massachusetts-based firm specializing in shareholder communications and investor relations intelligence services, for \$40.0 million in cash, subject to post-closing adjustments. We operate Shareholder.com as a wholly-owned subsidiary and it is included in our Issuers Services segment. The condensed consolidated financial statements include the operating results from the date of acquisition.

The following table presents a summary of the Shareholder.com acquisition:

Purchase Consideration	Total Net (Liabilities) Acquired	Purchased Intangible Assets	Goodwill
(in thousands)			
\$ 40,000	\$ (2,069)	\$ 10,159	\$ 31,910

We will finalize the purchase price allocation for the Shareholder.com acquisition within one year from the purchase date. We expect future adjustments related to taxes and settlement of post-closing adjustments. See Note 4, Goodwill and Purchased Intangible Assets, for further discussion.

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

The following table presents the details of the purchased intangible assets acquired in the Shareholder.com acquisition. All purchased intangible assets are amortized over the straight-line method.

Technology		Customer Relationships		Other		Total
Estimated Useful Life (in Years)	Amount	Estimated Useful Life (in Years)	Amount	Estimated Useful Life (in Years)	Amount	Amount
(in thousands, except years)						
5	\$ 959	11	\$ 6,800	Indefinite	\$ 2,400 ⁽¹⁾	\$ 10,159

⁽¹⁾ Represents the Shareholder.com trade name which we determined to have an indefinite estimated useful life.

Pro Forma Financial Information for Previous Acquisition

On December 8, 2005, we acquired INET. The condensed consolidated financial statements include the operating results of INET from the date of acquisition. Unaudited pro forma combined historical results to reflect INET for the three and six months ended June 30, 2005 are included in the table below. For the three and six months ended June 30, 2005, the unaudited pro forma historical results combine the historical condensed consolidated statements of income of Nasdaq and INET, giving effect to the INET acquisition as if it had occurred on January 1, 2005. We also acquired Shareholder.com in 2006 and Carpenter Moore in 2005, but have not included results from these businesses in these pro forma results as these acquisitions were not considered significant under Regulation S-X.

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005
(in thousands, except per share amounts)		
Total revenues	\$ 324,047	\$ 618,017
Gross margin	155,517	310,139
Net income	17,273	25,837
Net income applicable to common stockholders	15,029	21,660
Basic earnings per share	\$ 0.19	\$ 0.27
Diluted earnings per share	\$ 0.16	\$ 0.25

The pro forma results include amortization of purchased intangible assets and the elimination of intercompany transactions had Nasdaq and INET acted as a combined company. The pro forma results also include additional interest expense recorded for the debt incurred and restructured in connection with the financing of the INET acquisition, which included: (1) the issuance of \$205 million convertible notes to Silver Lake Partners, II, L.P., or SLP, (\$145.0 million) and Hellman & Friedman Capital Partners IV, L.P., or H&F, (\$60.0 million) on April 22, 2005, (2) the restructuring of the \$240 million convertible notes issued to H&F (including a \$7.4 million pre-tax loss on the restructuring) and (3) the issuance of the \$750 million senior term debt. 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 2005, nor are they necessarily indicative of future consolidated results.

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

4. Goodwill and Purchased Intangible Assets

Goodwill

The following table presents the changes in goodwill by segment during the six months ended June 30, 2006:

	Market Services	Issuers Services	Total
	(in thousands)		
Balance at December 31, 2005	\$ 941,275	\$ 20,618	\$ 961,893
Goodwill acquired		31,910	31,910
Purchase accounting adjustments	(5,822)	296	(5,526)
Balance at June 30, 2006	\$ 935,453	\$ 52,824	\$ 988,277

The net increase in goodwill during the six months ended June 30, 2006 primarily relates to the acquisition of Shareholder.com and purchase accounting adjustments related to the acquisitions of INET, Carpenter Moore and Shareholder.com.

Purchased Intangible Assets

The following table presents details of our total purchased intangible assets both finite and indefinite lived:

	June 30, 2006			December 31, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Intangible Assets	Gross Carrying Amount	Accumulated Amortization	Net Intangible Assets
	(in thousands)					
Technology	\$ 27,059	\$ (13,980)	\$ 13,079	\$ 26,100	\$ (4,108)	\$ 21,992
Customer relationships	202,400	(12,441)	189,959	196,400	(4,775)	191,625
Other	5,170	(957)	4,213	1,970	(109)	1,861

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Total	\$ 234,629	\$ (27,378)	\$ 207,251	\$ 224,470	\$ (8,992)	\$ 215,478
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

The estimated future amortization expense of our purchased intangible assets at June 30, 2006 is as follows:

	(in thousands)
2006	\$ 12,566
2007	18,852
2008	18,674
2009	18,643
2010 and thereafter	136,116
	<u> </u>
Total	\$ 204,851
	<u> </u>

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

The changes in net purchased intangible assets by segment during the six months ended June 30, 2006 were as follows:

	Market Services	Issuers Services	Total
	(in thousands)		
Balance at December 31, 2005	\$ 206,207	\$ 9,271	\$ 215,478
Intangible assets acquired		10,159	10,159
Amortization expense	(17,605)	(781)	(18,386)
Balance at June 30, 2006	\$ 188,602	\$ 18,649	\$ 207,251

5. 2006 and 2005 Cost Reduction Program, INET Integration and Strategic Review

Cost Reduction Program and INET Integration

We incurred charges of approximately \$17.9 million in the second quarter of 2006 and approximately \$31.5 million in the six months ended June 30, 2006 in connection with actions we took to improve our operational efficiency as well as to integrate INET. We incurred charges of approximately \$5.9 million in the second quarter of 2005 and approximately \$13.4 million in the six months ended June 30, 2005 in connection with actions we took to improve our operational efficiency. The following table summarizes these charges which are included in the Condensed Consolidated Statements of Income:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2006	2005	2006	2005
	(in millions)		(in millions)	
Real estate consolidation	\$ 5.4	\$ 1.1	\$ 5.4	\$ 4.4
Reductions in force	2.6	1.2	4.3	1.6
Technology migration	9.9	3.6	21.8	7.4
Total	\$ 17.9	\$ 5.9	\$ 31.5	\$ 13.4

Real Estate Consolidation

During 2004, our management re-evaluated all of our owned and leased real estate and determined that we would consolidate staff into fewer locations and save significant costs. As part of our real estate consolidation plans, in the second quarter of 2006, we decided to sell our building and related assets located in Trumbull, Connecticut. As a result of this decision, the carrying value of the building and related assets was adjusted to its fair market value less costs to sell amounting to \$30.8 million, which was determined based on a quoted market price from an independent third party. The resulting \$5.4 million charge recorded in April 2006 was included in general and administrative expense in the Condensed Consolidated Statements of Income. On July 28, 2006, we completed the sale of this building and related assets for approximately \$30.4 million. See Note 16, Subsequent Events, for further discussion.

In 2005, we changed the estimated useful life of certain data center and other assets and recorded charges for accelerated depreciation of \$1.1 million in the second quarter of 2005 and \$4.4 million for the six months ended June 30, 2005. We included these charges in depreciation and amortization expense in the Condensed Consolidated Statements of Income.

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

Reductions in Force

We eliminated 42 positions in the second quarter of 2006 and 23 positions in the second quarter of 2005 and recorded charges of \$2.6 million in the second quarter of 2006 and \$1.2 million in the second quarter of 2005 for severance and outplacement costs. We eliminated 64 positions in the six months ended June 30, 2006 and 29 positions in the six months ended June 30, 2005 and recorded charges of \$4.3 million in the six months ended June 30, 2006 and \$1.6 million in the six months ended June 30, 2005 for similar costs. These charges were included in compensation and benefits expense in the Condensed Consolidated Statements of Income. We paid approximately \$1.6 million during the quarter ended June 30, 2006 and \$0.2 million during the quarter ended June 30, 2005 and \$2.7 million during the six months ended June 30, 2006 and \$0.3 million during the six months ended June 30, 2005 for these severance and outplacement costs. We expect to pay the remainder of the severance and outplacement costs by the end of the third quarter of 2007. Total headcount increased from 768 employees at June 30, 2005 to 887 employees at June 30, 2006 as a result of employees acquired in the Shareholder.com acquisition in 2006 and the INET and Carpenter Moore acquisitions in 2005, partially offset by staff reductions.

Technology Migration

As a result of a continued review of our technology infrastructure, we shortened the estimated useful life of certain assets and changed the lease terms on certain operating leases associated with our quoting platform and our trading and quoting network as we continue to migrate our technology operations to fewer, scalable, less expensive platforms, which resulted in incremental depreciation and amortization expense. The INET integration has accelerated our migration to a low-cost trading platform. As a result, the charges associated with these assets were \$9.9 million for the second quarter of 2006 and \$21.8 million in the six months ended June 30, 2006. Of these amounts, \$9.4 million for the second quarter of 2006 and \$21.3 million in the six months ended June 30, 2006 were included in depreciation and amortization expense and for both periods \$0.5 million was included in computer operations and data communications expense in the Condensed Consolidated Statements of Income. The charges associated with these assets were \$3.6 million for the second quarter of 2005 and \$7.4 million in the six months ended June 30, 2005 and were included in depreciation and amortization expense in the Condensed Consolidated Statements of Income.

Strategic Review

During the second quarter of 2003, we announced the results of a strategic review of our operations designed to position us for improved profitability and growth. This strategic review included the elimination of non-core product lines and initiatives and resulted in a reduction in our workforce.

The liability for strategic review costs was \$5.8 million at December 31, 2005. In the first quarter of 2006, we funded the majority of the remaining reserves, except a contractual sublease obligation that will continue through 2010. At June 30, 2006, the liability was approximately \$1.0 million and is included in other liabilities in the Condensed Consolidated Balance Sheets.

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

6. Investments

The following tables summarize investments classified as available-for-sale that are carried at fair market value in the Condensed Consolidated Balance Sheets.

<u>June 30, 2006</u>	<u>Cost</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Market Value</u>
		(in thousands)	
Investment in the LSE	\$ 1,171,066	\$ 30,947 ⁽¹⁾	\$ 1,140,119
U.S. treasury securities and obligations of U.S. government agencies	17,700	233	17,467
Corporate bonds	48,313	157	48,156
Auction rate and other securities	9,783		9,783
Total	\$ 1,246,862	\$ 31,337	\$ 1,215,525

⁽¹⁾ Amount includes an unrealized loss of approximately \$61.9 million which was partially offset by a foreign currency translation adjustment gain of approximately \$31.0 million.

<u>December 31, 2005</u>	<u>Cost</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Market Value</u>
		(in thousands)	
U.S. treasury securities and obligations of U.S. government agencies	\$ 50,400	\$ 867	\$ 49,533
Obligations of states and political subdivisions	6,062	15	6,047
Auction rate securities	123,856	67	123,789
Total	\$ 180,318	\$ 949	\$ 179,369

Investment in the LSE

The following table summarizes the purchase of our 25.3% ownership stake in the LSE at June 30, 2006:

<u>Date Purchased</u>	<u>Total Consideration</u>
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	Number of Shares	Purchase Price Per Share			Percentage Ownership
			(in millions)		
April 18, 2006	38,100,000	£ 11.75	£ 447.7	\$ 784.8	14.9%
May 8, 2006	9,790,280	£ 12.18	119.2	220.7	18.7%
May 15, 2006	13,791,440	£ 12.48	172.1	321.4	24.1%
May 23, 2006	1,086,216	£ 12.38	13.5	25.4	24.6%
May 24, 2006	1,133,034	£ 12.33	14.0	26.3	25.1% ⁽²⁾
Total	63,900,970 ⁽¹⁾		£ 766.5	\$ 1,378.6	

⁽¹⁾ As a result of the LSE's capital return, we currently own 54,225,405 shares of the LSE. See below for further discussion.

⁽²⁾ After taking into effect the LSE's recent share buyback in June 2006, our total percentage ownership is approximately 25.3%.

On March 7, 2006, the LSE announced that shareholders of record on May 12, 2006 would receive a capital return of approximately GBP 510 million later in May 2006. On May 26, 2006, based on our share ownership, which includes the shares that settled through May 15, 2006, we received GBP 123.4 million, or \$228.8 million, which was recorded as a reduction to the cost basis in our investment. As a result of the capital return, we

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

currently own 54,225,405 shares of the LSE. In addition, on May 26, 2006, we also received an ordinary dividend of approximately GBP 4.9 million, or \$9.2 million, from the LSE which was recorded in dividend income in the Condensed Consolidated Statements of Income.

To finance the above purchases, we entered into credit facilities and utilized cash on hand of approximately \$287.6 million. See Note 8, Debt Obligations, for further discussion of the credit facilities. In connection with the financing, as of June 30, 2006, we incurred additional acquisition costs of approximately GBP 7.2 million, or \$13.1 million, to acquire our stake in the LSE. These costs such as stamp duty reserve tax, brokerage, legal and advisory were recorded as an addition to the cost basis in our investment.

In accordance with FIN 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock an interpretation of APB Opinion 18, or FIN 35, and APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, or APB 18, an investment (direct or indirect) of 20%, such as ours in the LSE, generally leads to a presumption that an investor has the ability to exercise significant influence over an investee, requiring the investment to be accounted for under the equity method of accounting. We concluded that we are not able to exercise significant influence over the operational and financial policies of the LSE pursuant to paragraph 4d of FIN 35 as the equity method of accounting for our investment in the LSE would require the LSE to routinely provide us with certain non-public information and information not available to its other shareholders, in order to convert LSE's results to GAAP and prepare a full purchase price allocation as required under APB 18. At this point, this information is not available to us. Therefore, we have concluded that we do not exert significant influence over the LSE and that the equity method of accounting is not required. Thus we will account for our investment in the LSE in accordance with SFAS 115, Accounting for Certain Investments in Debt and Equity Securities, or SFAS 115, and include our LSE shares in available-for-sale investments, at fair value in the Condensed Consolidated Balance Sheets. Unrealized gains and losses, including foreign currency translation adjustments are included in accumulated other comprehensive income in the Condensed Consolidated Balance Sheets until the sale or redemption of the shares.

7. Deferred Revenue

Our deferred revenue at June 30, 2006 is primarily related to Corporate Client Group fees and will be recognized in the following years:

	Initial Listing Fees	Listing of Additional Shares	Annual and Other ⁽¹⁾	Total
	(in thousands)			
Fiscal year ended:				
2006	\$ 10,432	\$ 18,009	\$ 60,165	\$ 88,606
2007	18,250	31,633	196	50,079
2008	15,559	21,381		36,940
2009	12,227	10,557		22,784
2010 and thereafter	13,273	1,805		15,078
Total	\$ 69,741	\$ 83,385	\$ 60,361	\$ 213,487

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- (1) Primarily includes Corporate Client Group's annual listing fees, as well as annual listing fees from mutual fund products from Nasdaq Market Services Subscriptions and licensing revenues from Nasdaq Financial Products.

Our deferred revenue for the six months ended June 30, 2006 and 2005 is reflected in the following tables. The additions primarily reflect Corporate Client Group revenues from listing fees charged during the period while the amortization primarily reflects Corporate Client Group revenues from listing fees recognized during the period in accordance with GAAP.

	Initial Listing Fees	Listing of Additional Shares	Annual and Other	Total
	(in thousands)			
Balance at January 1, 2005	\$ 74,300	\$ 75,058	\$	\$ 149,358
Additions	10,568	25,390	115,311	151,269
Amortization	(15,259)	(18,844)	(57,029)	(91,132)
Balance at June 30, 2005	\$ 69,609	\$ 81,604	\$ 58,282	\$ 209,495

The following table presents the changes in our debt obligations during the six months ended June 30, 2006:

[illegible]

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\$750.0 million senior term loan facility due April 18, 2012 (average interest rate of 6.97% at June 30, 2006)		750,000	(1,875)	748,125
\$434.8 million term loan credit agreement due April 18, 2012 (average interest rate of 6.98% at June 30, 2006)		1,100,000	(666,328)	433,672
		<u> </u>	<u> </u>	<u> </u>
Total debt obligations	1,192,428	1,850,000	(1,418,015)	1,624,413
Less current portion	(7,500)	(4,348)		(11,848)
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Total long-term debt obligations	\$ 1,184,928	\$ 1,845,652	\$ (1,418,015)	\$ 1,612,565
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

The 3.75% convertible notes include the \$205 million convertible notes issued at a discount to SLP and H&F and the restructured \$240 million convertible notes issued at a premium to H&F. On an as-converted basis at June 30, 2006, H&F owned an approximate 18.1% equity interest in us as a result of its ownership of the \$240 million convertible notes, \$60.0 million of the \$205 million convertible notes, 3,400,000 shares underlying

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

warrants and 500,000 shares of common stock purchased from us in a separate transaction. On an as-converted basis at June 30, 2006, SLP owned an approximate 10.5% equity interest in us as a result of its ownership of \$145.0 million of the \$205 million convertible notes, 1,562,500 shares underlying warrants and 1,430,250 shares of common stock owned by SLP affiliates.

On April 18, 2006, in order to finance the purchase of our stake in the LSE, we entered into new credit agreements, or the April 2006 Credit Facility. The April 2006 Credit Facility provided for credit of up to \$1.925 billion of secured financing (see details below) and replaced our former credit agreement dated December 8, 2005 obtained in connection with the financing of the INET acquisition. In connection with the refinancing of our former credit agreement, we recorded a \$12.3 million loss on the early extinguishment of this debt in April 2006, which we included in general and administrative expense in the Condensed Consolidated Statements of Income.

The \$1.925 billion available under the April 2006 Credit Facility included:

- (1) a six-year \$750.0 million senior term loan facility,
- (2) a five-year un-drawn \$75.0 million revolving credit facility, with a letter of credit subfacility and swingline loan subfacility and
- (3) a six-year \$1.1 billion secured term loan facility.

On May 2, 2006, we completed a public offering of 18,500,000 shares of our common stock, for net proceeds of \$665.2 million before deducting offering expenses. These proceeds were used to prepay a portion of the amount outstanding under the April 2006 Credit Facility. In connection with this prepayment we recorded a loss of \$8.6 million on the early extinguishment of a portion of this debt in May 2006, which was included in general and administrative expense in the Condensed Consolidated Statements of Income.

On May 19, 2006, the April 2006 Credit Facility was amended into two new credit facilities, or the Credit Facilities, and currently provides for credit up to \$1.26 billion of secured financing. See *Credit Facilities*, below for further discussion.

At June 30, 2006 we were in compliance with the covenants of all of our debt agreements.

Credit Facilities

As discussed above, on May 19, 2006, the April 2006 Credit Facility was amended and the Credit Facilities currently provide for credit up to \$1.26 billion of secured financing. The \$1.26 billion available under the Credit Facilities includes:

(1) \$825.0 million senior credit agreement, which includes:

a six-year \$750.0 million senior term loan facility, or \$750.0 million senior term loan facility and

a five-year un-drawn \$75.0 million revolving credit facility, with a letter of credit subfacility and swingline loan subfacility.

(2) \$434.8 million six-year secured term loan credit agreement, or \$434.8 million term loan credit agreement.

Any amounts prepaid under the Credit Facilities, excluding the un-drawn \$75.0 million revolving credit facility, constitute permanent reductions in availability.

The Nasdaq Stock Market, Inc.

Notes to Condensed Consolidated Financial Statements (Continued)

The interest rate on loans made under the Credit Facilities, excluding the un-drawn \$75.0 million revolving credit facility, is expected to be either:

(1) a margin of 75 basis points (decreasing to a margin of 50 basis points on the earlier of either the outstanding amounts under the Credit Facilities is less than or equal to \$750.0 million, or when the Credit Facilities receive a rating of Ba2 (stable outlook or better) or higher by Moody's Investors Service, Inc. and a rating of BBB (stable outlook or better) or higher by Standards & Poor's Ratings Group, Inc.) plus a rate per annum equal to the greater of:

(a) the rate announced from time to time by Bank of America, N.A. as its prime rate and

(b) the federal funds effective rate plus $\frac{1}{2}$ of 1%, or

(2) a margin of 175 basis points (decreasing to a margin of 150 basis points on the earlier of either the outstanding amounts under the Credit Facilities is less than or equal to \$750.0 million, or when the Credit Facilities receive a rating of Ba2 (stable outlook or better) or higher by Moody's and a rating of BBB (stable outlook or better) or higher by Standards & Poor's) plus the LIBO Rate set by the British Bankers' Association at 11:00 a.m. two days prior, in each case.

Nasdaq has also agreed to pay customary fees and expenses related to the Credit Facilities and to provide customary indemnities.

Our obligations under the Credit Facilities are secured by a security interest in and liens upon substantially all of our assets and subsidiaries. All of our domestic subsidiaries are guarantors of our obligations under the Credit Facilities, excluding the regulated broker-dealer subsidiaries, the insurance-related subsidiaries and The Trade Reporting Facility LLC, or TRF, a joint venture with National Association of Securities Dealers, Inc., or NASD, which we formed in April 2006 as part of our exchange registration. See Exchange Registration, of Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations, for further discussion.

The Credit Facilities contain customary negative covenants which will affect our subsidiaries and us, including the following:

limitations on the payment of dividends and redemptions of our capital stock;

limitations on loans, guarantees, investments, incurrence of debt and hedging arrangements;

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limitations on issuance and amendment of preferred stock and amendment of subordinated debt agreements;

prohibition of prepayments, redemptions and repurchases of debt other than debt under the Credit Facilities;

limitations on liens and sale-leaseback transactions;

limitations on mergers, recapitalizations, acquisitions and asset sales;

limitations on transactions with affiliates;

limitations on restrictions on liens and other restrictive agreements; and

limitations on changes in our business.

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Notes to Condensed Consolidated Financial Statements (Continued)

In addition, the Credit Facilities contain financial covenants, specifically, a maintenance of minimum interest expense coverage ratio and maximum leverage ratio, as defined in the Credit Facilities and pursuant to the following schedules:

Interest Expense Coverage Ratio

Period	Ratio
April 18, 2006 to September 30, 2006	2.00 to 1.00
October 1, 2006 to March 31, 2007	2.25 to 1.00
April 1, 2007 to March 31, 2008	2.50 to 1.00