# 04

CHICAGO STOCK EXCHANGE, INC.

*2004 Annual Report*

## Dear Shareholders, Customers and Staff

**Change. In the past several years, change has been the only predictable factor for the unpredictable securities industry. In 2004, CHX put tremendous effort into adapting our trading platform in ways that will allow the Exchange even greater flexibility to respond to the rapidly evolving world of trading.**

### STRUCTURAL CHANGE

Mid-year Board approval and a near unanimous membership vote paved the way for a February 2005 SEC approval of the Exchange's transition from a not-for-profit non-stock organization owned by its members to a wholly owned subsidiary of a holding company, CHX Holdings, Inc. Members received shares of common stock of the holding company and are now stockholders of the new for-profit stock corporation. Those members who were specialists, floor brokers, market-makers or customers of the Exchange also received trading permits necessary for continued access to the trading facilities of the Exchange.

Although this transition resulted in little immediate impact on CHX customers, completion of this demutualization was an important step, giving the Exchange the flexibility needed to compete in the rapidly changing environment. Our new structure will allow us to more easily explore and execute strategic partnerships with other marketplaces, technology providers and order routing networks.

### TECHNOLOGY INITIATIVES

Our technology efforts in 2004 led to substantial progress on key CHX initiatives, the CHXpress™ order type and an electronic book offering. During the fourth quarter we launched CHXpress functionality allowing customers to choose immediacy of order display, execution and cancellation without the interaction of floor brokers or specialists who often act as agent for the execution of more traditional orders. Although this offering has been implemented only in a limited number of issues, it has been greeted in those issues with significant interest from both "smart" routing networks interested in accessing the best available market and firms that have developed algorithmic trading models looking to access and display liquidity in the National Market System.

Technology work on our electronic book initiative was also completed in 2004. Awaiting final SEC approval, this offering will allow CHX participants order display, cross and execution capabilities in all CHX issues without an assigned specialist. We are working diligently with the SEC to receive final approval to roll out this offering in 2005.

As an ongoing major initiative, CHX has been working to find technology solutions that better prevent and identify potential rules violations. During 2005 we made significant progress in implementing tools to reduce the likelihood of trading ahead violations by automatically replacing principal interest to trade with agency interest whenever an agency order resides at the Exchange.

### REGULATORY EFFORTS

In addition to technology efforts designed to identify and prevent regulatory violations, CHX regulatory staff worked throughout 2004 with an independent regulatory consultant and the SEC to improve our surveillance and enforcement programs. During the latter part of 2004, Exchange staff began implementing some of the suggestions – and designed implementation plans for the remaining suggestions – in order to carry out the changes during 2005 and 2006.

The CHX also explored ways to address significant new SEC rule proposals. Many provisions of Reg SHO – the SEC's new short sale rule – have taken effect and the pilot program for the trading of certain securities without a short sale bid or tick test has begun. The Exchange's systems are ready to handle the new requirements. More importantly, after two separate comment periods, the SEC has approved Reg NMS – the most comprehensive set of changes to the National Market System in many years. The Exchange plans to be a "fast market" under the new trade-through rules and will be making appropriate changes to its systems to be ready for the implementation of these rules in 2006.

### FINANCIAL RESULTS

CHX financial results continue to suffer as we adapt our fees and trading model to evolving market conditions. Revenues were $37.3 million in 2004 – an 18.4% reduction from $45.7 million in 2003. $3.2 million of that gap was attributable to reductions in fees and increases in rebates in order keep customer expenses in line with other trading venues.

CHX net comprehensive loss increased from $3.4 million in 2003 to $10.8 million in 2004. Cash and investment securities decreased by $6.7 million – from $28.4 million at the end of 2003 to $21.7 million at the end of 2004.

In response to these declines, management continued to focus on cost containment and reduced expenses by 8.5% from $50.6 million in 2003 to $46.3 million in 2004. Included in the 2004 operating expenses are $3.8 million in charges related to excess space, severance and SEC related consulting fees. Such charges amounted to $3.4 million in 2003. In addition, in 2004 CHX incurred $600,000 of demutualization related expense. Mid-year expense reduction efforts and an anticipated reduction in outside consulting fees allowed the CHX to enter 2005 with anticipated expenses of $39.6 million.

### THE YEAR AHEAD

The CHX entered 2005 with a new corporate structure, a streamlined expense base and new tools designed to broaden our appeal to the professional trading community that is dominating trade activity. Yet, recognizing that change is the only constant in this industry, CHX will continue adapting to meet the challenges ahead.

Strategic initiatives (remote facility pricing, CHXpress order type and electronic book capabilities) executed over the last two years have laid the groundwork for continued migration to a more fully electronic trading model capable of attracting new business to the Exchange while enhancing our ability to service existing retail and institutional customers.

The securities markets will continue to face change as we react to regulatory initiatives and market forces. We believe that the CHX has the financial resources, professional staff and customer base that will enable the Exchange to continue to be a strong participant within the National Market System.

Valerie B. Jarrett
CHAIRMAN

David A. Herron
CHIEF EXECUTIVE OFFICER

Andrew A. Davis
VICE CHAIRMAN

## Balance Sheets

DECEMBER 31, 2004 AND 2003

| | 2004 | 2003 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 6,605,000 | $ 5,512,000 |
| Investment securities | 12,059,000 | 12,679,000 |
| Accounts receivable (net) | 6,770,000 | 8,027,000 |
| Deferred income taxes | — | 1,335,000 |
| Prepaid expenses | 1,006,000 | 1,018,000 |
| Other current assets | 232,000 | 427,000 |
| *Total current assets* | 26,672,000 | 28,998,000 |
| Investment securities | 2,986,000 | 10,185,000 |
| Deferred income taxes | — | 1,957,000 |
| Equipment, leasehold improvements, software and other capitalized costs (net) | 13,032,000 | 16,435,000 |
| Prepaid pension | 4,191,000 | 3,694,000 |
| *Total assets* | $46,881,000 | $61,269,000 |
| **LIABILITIES AND MEMBERS' EQUITY** | | |
| **Current liabilities** | | |
| Section 31 fees payable | $ 3,999,000 | $ 7,033,000 |
| Other accounts payable | 707,000 | 1,347,000 |
| Other current liabilities | 6,053,000 | 6,590,000 |
| *Total current liabilities* | 10,759,000 | 14,970,000 |
| Other liabilities | 12,548,000 | 11,959,000 |
| Members' equity | 23,574,000 | 34,340,000 |
| *Total liabilities and members' equity* | $46,881,000 | $61,269,000 |

*See notes to financial statements.*

## Statements of Operations

YEARS ENDED DECEMBER 31, 2004 AND 2003

| | 2004 | 2003 |
|---|---|---|
| **Revenues** | | |
| Transaction fees | | |
| (Net of Floor Broker credits of $2,957,000 and $2,830,000) | $ 17,873,000 | $ 21,231,000 |
| Member services and fees | 12,593,000 | 13,660,000 |
| Market data fees | | |
| (Net of Specialist credits of $2,183,000 and $1,318,000) | 3,098,000 | 6,940,000 |
| Member dues | 2,700,000 | 2,700,000 |
| Listing fees | 619,000 | 571,000 |
| Interest | 451,000 | 560,000 |
| Other | — | 11,000 |
| *Total revenues* | 37,334,000 | 45,673,000 |
| **Expenses** | | |
| Employee compensation and benefits | 18,173,000 | 21,303,000 |
| Communications, equipment and related costs | 7,236,000 | 7,291,000 |
| Depreciation and amortization | 6,222,000 | 7,121,000 |
| Professional and other outside services | 5,483,000 | 4,992,000 |
| Facilities rent, maintenance and utilities | 4,513,000 | 5,361,000 |
| General and administrative | 2,683,000 | 2,521,000 |
| Loss on excess leased space | 1,995,000 | 1,860,000 |
| Loss on impairment of fixed assets | — | 153,000 |
| *Total expenses* | 46,305,000 | 50,602,000 |
| Loss before income taxes | (8,971,000) | (4,929,000) |
| Income tax expense (benefit) | 1,486,000 | (1,573,000) |
| Net loss | $ (10,457,000) | (3,356,000) |
| Minimum pension liability adjustment | (309,000) | — |
| *Comprehensive loss* | $ (10,766,000) | $ (3,356,000) |

*See notes to financial statements.*

## Statements of Cash Flows

YEARS ENDED DECEMBER 31, 2004 AND 2003

| | 2004 | 2003 |
|---|---|---|
| **Cash flows from operating activities** | | |
| Net loss | $ (10,457,000) | $ (3,356,000) |
| Adjustments to reconcile net loss to net cash flows from operating activities: | | |
| Gain on sale of fixed assets | — | (11,000) |
| Depreciation and amortization | 6,222,000 | 7,121,000 |
| Loss on excess leased space | 1,995,000 | 1,860,000 |
| Loss on impairment of fixed assets | — | 153,000 |
| Deferred income tax benefit | 3,292,000 | (48,000) |
| Changes in: | | |
| Accounts receivable (net) | 1,257,000 | 406,000 |
| Prepaid expenses | 12,000 | 36,000 |
| Other current assets | 195,000 | (63,000) |
| Prepaid pension | (497,000) | (193,000) |
| Other noncurrent assets | — | 80,000 |
| Section 31 fees payable | (3,034,000) | 2,574,000 |
| Taxes payable | — | (1,458,000) |
| Other accounts payable | (640,000) | (374,000) |
| Other liabilities | (1,060,000) | 578,000 |
| Other noncurrent liabilities | (1,192,000) | (371,000) |
| *Net cash flows from operating activities* | (3,907,000) | 6,934,000 |
| **Cash flows from investing activities** | | |
| Purchases of investment securities | (11,781,000) | (23,687,000) |
| Proceeds from maturities of investment securities | 19,600,000 | 17,380,000 |
| Capital expenditures | (2,819,000) | (3,755,000) |
| Proceeds from sale of fixed assets | — | 40,000 |
| *Net cash flows from investing activities* | 5,000,000 | (10,022,000) |
| Net change in cash and cash equivalents | 1,093,000 | (3,088,000) |
| Cash and cash equivalents, beginning of year | 5,512,000 | 8,600,000 |
| *Cash and cash equivalents, end of year* | $ 6,605,000 | $ 5,512,000 |
| **Supplemental disclosures** | | |
| *Cash paid during the year for income taxes* | $ — | $ 646,000 |

*See notes to financial statements.*

# Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

## 1. Description of the Business and Basis of Presentation

The Chicago Stock Exchange, Inc. is an equity exchange in the United States of America. The financial statements include the accounts of the Chicago Stock Exchange, Inc. (the "Exchange"). On February 9, 2005, the Exchange demutualized and was converted from a Delaware non-stock corporation into a Delaware stock corporation, as more fully described in note 14.

As shown in the financial statements, the Exchange incurred significant losses of $10,766,000 and $3,356,000 during the years ended December 31, 2004 and 2003, respectively, and used cash in its operations of $3,907,000 during the year ended December 31, 2004. Management reviewed the Exchange's business model and overall operations and presented a revised business plan to the Board of Directors. The Board of Directors approved the plan, which includes significant investment, to reposition the Exchange and its operations. The cash and investment securities balances available at December 31, 2004, and anticipated cash generated from continuing operations are expected to be sufficient to fund the operations and investments of the revised business plan during its implementation. The implementation of the revised business plan may result in additional asset impairment or other charges.

## 2. Summary of Significant Accounting Policies

CASH EQUIVALENTS — Cash equivalents consist of money market funds which invest in U.S. Treasury bills, notes, bonds and other U.S. obligations issued or guaranteed by the U.S. Treasury and securities purchased under resale agreements collateralized by U.S. Government securities.

INVESTMENT SECURITIES — Investment securities consist of U.S. Government agency securities. The Exchange has the ability and the positive intent to hold these securities to maturity and therefore they are carried at amortized cost.

DEPRECIATION AND AMORTIZATION — Depreciation is provided on the straight-line method, over useful lives of generally three to five years for computer equipment and four to ten years for other equipment and office furnishings. Leasehold improvements are amortized over the shorter of the life of the asset or the term of the lease. Capitalized costs are amortized using a straight-line method typically over three to five years.

IMPAIRMENT OF LONG-LIVED ASSETS — Long-lived assets are reviewed for possible impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If such review indicates that the carrying amount of a long-lived asset is not recoverable, the carrying amount is reduced to the estimated recoverable value.

INCOME TAXES — Income tax expense is calculated under the liability method. Accordingly, deferred tax assets and liabilities are determined based upon the differences between financial statement carrying amounts and the tax bases of existing assets and liabilities, and are measured at the tax rates that will be in effect when these differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized against future taxable income.

REVENUE RECOGNITION — *Transaction fees* are imposed on certain trades executed on the Exchange and are recorded as of the trade date. Floor brokers earn a monthly transaction fee credit based upon a formula that incorporates the total number of shares executed on the Exchange by the floor broker for which the Exchange received a transaction fee. *Market data fees* are earned on the sale of market transaction information and are derived from market share data. Market data fees are recorded on an accrual basis when earned. Specialists earn a monthly market data fee credit based upon a percentage of monthly Exchange market data fee revenue from the Consolidated Tape Association ("CTA"), generated by a particular stock. *Member services and fees* consist principally of fixed fees charged to specialists based upon assigned stocks, purchases of services by the Exchange and rebilled to members, trading floor space rent, clearing fees and other fees. Such fees are recognized over the period the fees are earned. *Member dues* are recognized on an accrual basis when earned. *Listing fees* represent fees charged to security issuers for listing on the Exchange and are generally recognized ratably over the year.

# Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

## 2. Summary of Significant Accounting Policies *continued*

ESTIMATES — The preparation of the financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts in the financial statements. Actual amounts realized may differ from those estimates.

RECLASSIFICATIONS — Certain reclassifications have been made of prior year amounts to conform to current year presentation.

## 3. Investment Securities

The fair values of investment securities were determined using closing market prices. Such prices were attained from an independent pricing source. The Exchange classifies held-to-maturity securities as current if they mature within the next twelve months. All other held-to-maturity securities are classified as non-current. Investment securities consisted of the following:

| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Fair Value |
|---|---|---|---|---|
| **U.S. Government agency obligations held-to-maturity at December 31, 2004** | | | | |
| *Current* | $12,059,000 | $ — | $(53,000) | $12,006,000 |
| *Noncurrent* | $ 2,986,000 | $ — | $(15,000) | $ 2,971,000 |
| **U.S. Government agency obligations held-to-maturity at December 31, 2003** | | | | |
| *Current* | $12,679,000 | $ 27,000 | $ — | $12,706,000 |
| *Noncurrent* | $10,185,000 | $ 20,000 | $ (2,000) | $10,203,000 |

## 4. Accounts Receivable (net)

Accounts receivable, net consisted of the following at December 31:

| | 2004 | 2003 |
|---|---|---|
| Receivables from members | $ 4,004,000 | $ 5,539,000 |
| Market data fees receivable | 1,301,000 | 1,813,000 |
| Income taxes receivable | 1,275,000 | 472,000 |
| Other receivables | 461,000 | 466,000 |
| *Subtotal* | 7,041,000 | 8,290,000 |
| Allowance | (271,000) | (263,000) |
| *Total* | $ 6,770,000 | $ 8,027,000 |

# Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

## 5. Equipment, Leasehold Improvements, Software and Other Capitalized Costs

Equipment, leasehold improvements, software and other capitalized costs consisted of the following at December 31:

| | 2004 | 2003 |
|---|---|---|
| Equipment and office furnishings | $ 12,866,000 | $ 24,110,000 |
| Leasehold improvements | 13,559,000 | 13,543,000 |
| Software and other capitalized costs | 8,924,000 | 12,115,000 |
| | 35,349,000 | 49,768,000 |
| Less accumulated depreciation and amortization | (22,317,000) | (33,333,000) |
| *Total* | $ 13,032,000 | $ 16,435,000 |

Software and other capitalized costs include purchased computer software, external costs specifically identifiable to the implementation of new systems, and certain payroll and payroll-related costs for employees who are directly associated with developing computer software for internal use.

## 6. Other Current Liabilities

Other current liabilities consisted of the following at December 31:

| | 2004 | 2003 |
|---|---|---|
| Accrued rent | $ 2,416,000 | $ 1,821,000 |
| Accrued incentive compensation | 411,000 | 1,206,000 |
| Accrued vacation | 525,000 | 1,031,000 |
| Accrued severance payable | 377,000 | 409,000 |
| Accrued operating expense | 2,324,000 | 2,123,000 |
| *Total* | $ 6,053,000 | $ 6,590,000 |

## 7. Members' Equity

At December 31, 2004 and 2003, 465 equity memberships were authorized, and 450 memberships were outstanding. The components of members' equity at December 31 were as follows:

| | 2004 | 2003 |
|---|---|---|
| Members' initial investment | $ 6,925,000 | $ 6,925,000 |
| Retained earnings | 16,958,000 | 27,415,000 |
| Accumulated other comprehensive income | (309,000) | — |
| *Members' equity* | $ 23,574,000 | $ 34,340,000 |
| *Equity per outstanding membership* | $ 52,387 | $ 76,311 |

## Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

### 8. Contingencies

The Exchange is involved in litigation incidental to its business. While the ultimate outcome of such litigation is uncertain, in the opinion of management, based on consultations with counsel and the information available, such litigation will not have a material adverse effect on the financial position or results of operations of the Exchange.

In September 2003, the Exchange settled an administrative proceeding with the Securities and Exchange Commission ("SEC") to resolve issues involving the Exchange's surveillance and enforcement of certain trading rules. The settlement includes a cease and desist order and requires the Exchange to comply with specific undertakings to improve its regulatory programs. As part of this settlement, the Exchange engaged an independent consultant to review its regulatory programs and to recommend further enhancements. In July 2004, the independent consultant submitted a report with findings and recommendations to the SEC. The Exchange will likely devote substantial resources over the next few years above its regular regulatory expenditures in order to effectuate the report's recommendations and to implement its own regulatory initiatives.

The Exchange's members are regulated by the Exchange and by the SEC. Both of these organizations can conduct investigations of member conduct and sanction members for violations of Exchange and SEC rules, as well as for violations of the federal securities laws. The SEC and the Exchange currently are conducting investigations of certain trading activity by specialists. These investigations are ongoing and it is not possible to identify what the final results may be. Due to the concentration of specialist units at the Exchange, however, if any regulatory actions result from the investigations, they could have an effect, and potentially a material effect, on the Exchange's specialist community and on the Exchange's specialist-driven business.

### 9. Income Taxes

The provision for income taxes for the years ended December 31 consisted of the following:

| | 2004 | 2003 |
|---|---|---|
| **Current** | | |
| Federal | $(1,963,000) | $(1,373,000) |
| State | 157,000 | (152,000) |
| *Total* | $(1,806,000) | $(1,525,000) |
| **Deferred** | | |
| Federal | $ 2,513,000 | 149,000 |
| State | 779,000 | (197,000) |
| *Total* | $ 3,292,000 | $ (48,000) |
| *Income tax expense (benefit)* | $ 1,486,000 | $(1,573,000) |

The provision for federal income taxes differed from that obtained at the statutory rate as follows:

| | 2004 | 2003 |
|---|---|---|
| Federal income tax (benefit), at statutory rate of 34 percent | $(3,050,000) | $(1,676,000) |
| State income tax (benefit), net of federal tax effect | 618,000 | (231,000) |
| Valuation and reserve adjustments | 3,909,000 | 310,000 |
| Nondeductible expenses | 9,000 | 24,000 |
| *Income tax (benefit)* | $ 1,486,000 | $(1,573,000) |

# Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

## 9. Income Taxes *continued*

The gross deferred tax assets and liabilities at December 31 were:

| | 2004 | 2003 |
|---|---|---|
| Deferred tax assets | | |
| Pension and FAS106 accruals | $ 2,543,000 | $ 2,369,000 |
| Accrued loss on excess leased space | 1,106,000 | 754,000 |
| Accrued rent | 808,000 | 581,000 |
| Accrued vacation | 158,000 | 357,000 |
| Net operating loss carryforward | 1,623,000 | — |
| Capital loss carryforward | 100,000 | 100,000 |
| Charitable contribution carryforward | 8,000 | 8,000 |
| Other | 1,132,000 | 1,354,000 |
| *Sub-total* | 7,478,000 | 5,523,000 |
| Valuation allowance | (6,384,000) | (1,100,000) |
| *Total deferred tax assets* | $ 1,094,000 | $ 4,423,000 |
| Deferred tax liabilities | | |
| Basis difference in fixed assets | $ (729,000) | $ (896,000) |
| Prepaid expenses | (365,000) | (235,000) |
| *Total deferred tax liabilities* | $(1,094,000) | $(1,131,000) |
| *Net deferred tax assets* | $ — | $ 3,292,000 |

Based upon consideration of the Exchange's recent history of operating losses and the uncertainty of overall Exchange profitability in the future, management believes that, at December 31, 2004, it is more likely than not the deferred tax assets will not be realized and a valuation allowance of $6,384,000 has been recorded to reduce the net deferred tax assets to $0. Management believes the valuation allowance of $1,100,000 at December 31, 2003 was sufficient to reduce the net deferred tax assets to the amount that was more likely than not to be realized.

## 10. Employee Benefit Plans

The Exchange has qualified and nonqualified defined benefit pension plans, and a retiree medical plan that cover all eligible employees as defined. The nonqualified pension plan, with an aggregate projected benefit obligation of $3,191,000 and $3,364,000 as of December 31, 2004 and 2003, respectively, are unfunded. In September 2004, the Exchange froze the future benefit accruals for the qualified and nonqualified defined benefit pension plans. The elimination of future benefit accruals triggered a curtailment event under SFAS No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*.

A reconciliation of beginning and ending balances of the benefit obligations, certain actuarial assumptions, fair value of plan assets, the funded status of the plans and the components of pension cost are indicated on the following pages:

## Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

### 10. Employee Benefit Plans *continued*

| | Pension Plans 2004 | Pension Plans 2003 | Postretirement Benefit Plan 2004 | Postretirement Benefit Plan 2003 |
|---|---|---|---|---|
| **Change in benefit obligation** | | | | |
| Benefit obligation at beginning of year | $33,911,000 | $30,621,000 | $ 2,944,000 | $ 2,822,000 |
| Service cost | 551,000 | 744,000 | 186,000 | 149,000 |
| Interest cost | 1,992,000 | 1,963,000 | 168,000 | 172,000 |
| Plan participant's contributions | — | — | 25,000 | 22,000 |
| Net actuarial loss (gain) | 2,142,000 | 1,502,000 | 335,000 | (31,000) |
| Benefits paid | (1,004,000) | (919,000) | (199,000) | (190,000) |
| Curtailment (gain) | (5,062,000) | — | — | — |
| *Benefit obligation at end of year* | $32,530,000 | $33,911,000 | $ 3,459,000 | $ 2,944,000 |
| **Weighted-average assumptions used to determine benefit obligations at December 31** | | | | |
| Discount rate | 5.75% | 6.25% | 5.75% | 6.25% |
| Rate of compensation increase | N/A | 4.50% | N/A | N/A |

The accumulated benefit obligation for all defined benefit pension plans at December 31, 2004 and 2003 was $32,530,000 and $28,955,000, respectively.

| | Pension Plans 2004 | Pension Plans 2003 |
|---|---|---|
| **Change in Plan Assets:** | | |
| Fair value of plan at beginning of year | $29,298,000 | $24,804,000 |
| Actual return on plan assets | 2,621,000 | 5,190,000 |
| Employer contribution | 229,000 | 223,000 |
| Benefits paid | (1,004,000) | (919,000) |
| *Fair value of plan at end of year* | $31,144,000 | $29,298,000 |

| | Pension Plans 2004 | Pension Plans 2003 | Postretirement Benefit Plan 2004 | Postretirement Benefit Plan 2003 |
|---|---|---|---|---|
| **Funded status at December 31** | | | | |
| Funded status | $ (1,386,000) | $ (4,613,000) | $(3,459,000) | $(2,944,000) |
| Unrecognized net actuarial loss (gain) | 2,695,000 | 5,448,000 | (16,000) | (389,000) |
| Unrecognized prior service cost | — | (18,000) | — | — |
| *Net amount recognized* | $ 1,309,000 | $ 817,000 | $(3,475,000) | $(3,333,000) |

# Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

## 10. Employee Benefit Plans *continued*

| | Pension Plans | | Postretirement Benefit Plan | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| **Amounts recognized in the statement of financial position consist of:** | | | | |
| Prepaid benefit cost | $ 4,191,000 | $ 3,694,000 | $ — | $ — |
| Accrued benefit liability | (3,191,000) | (2,877,000) | (3,475,000) | (3,333,000) |
| Accumulated other comprehensive income | 309,000 | — | — | — |
| *Net amount recognized* | $ 1,309,000 | $ 817,000 | $ (3,475,000) | $ (3,333,000) |

Information for pension plans with an accumulated benefit obligation in excess of plan assets at December 31:

| | Pension Plans | |
|---|---|---|
| | 2004 | 2003 |
| Projected benefit obligation | $ 3,191,000 | $ 3,364,000 |
| Accumulated benefit obligation | $ 3,191,000 | $ 2,877,000 |
| Fair value of plan asset | — | — |

| | Pension Benefits | | Postretirement Benefit Plan | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| **Components of Net Periodic Benefit Cost** | | | | |
| Service cost | $ 551,000 | $ 745,000 | $ 186,000 | $ 149,000 |
| Interest cost | 1,992,000 | 1,964,000 | 168,000 | 172,000 |
| Expected return on plan assets | (2,788,000) | (2,573,000) | — | — |
| Amortization of prior service cost | (3,000) | 1,000 | — | — |
| Recognized net actuarial loss (gain) | — | — | (38,000) | (49,000) |
| FAS 88 events | (15,000) | — | — | — |
| *Net periodic benefit cost* | $ (263,000) | $ 137,000 | $ 316,000 | $ 272,000 |

Weighted – average assumptions used to determine net periodic benefit costs for the years ended December 31:

| | Pension Benefits | | Postretirement Benefit Plan | |
|---|---|---|---|---|
| | 2004 | 2003 | 2004 | 2003 |
| Discount rate | 6.13% | 6.75% | 6.25% | 6.75% |
| Expected long-term return on plan assets | 8.69% | 8.75% | N/A | N/A |
| Rate of compensation increase | 4.50% | 4.50% | N/A | N/A |

## Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

### 10. Employee Benefit Plans *continued*

Assumed health care cost trend rates at December 31:

| | 2004 | 2003 |
|---|---|---|
| Health care cost trend rates assumed for next year | 10.00% | 8.50% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 5.00% | 4.75% |
| Year that the rate reaches the ultimate trend rate | 2010 | 2009 |

Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement benefit plan. A one-percentage-point change in assumed health care cost trend rates would have the following effects:

| | 1– Percentage Point Increase | 1– Percentage Point Decrease |
|---|---|---|
| Effect on total of service and interest cost components | $ 69,000 | $ (55,000) |
| Effect on post retirement benefit obligation | $ 532,000 | $ (437,000) |

PLAN ASSETS

The Chicago Stock Exchange's pension plan weighted – average asset allocation ranges at December 31, 2004 and 2003, by asset category are as follows:

| Asset Category | Plan Assets at December 31, 2004 | Plan Assets at December 31, 2003 |
|---|---|---|
| Equities | 50.0% – 80.0% | 55.0% – 75.0% |
| Fixed income | 20.0% – 40.0% | 20.0% – 40.0% |
| Cash equivalents | 0.0% – 10.0% | 0.0% – 10.0% |

The pension plan's total return is expected to equal the composite performance of the security markets on an annual basis. The security markets are represented by the returns on various domestic and international stock and bond indicies. These returns are weighted according to the allocation of plan assets to each market and measured individually.

The Exchange maintains a savings plan pursuant to Section 401(k) of the Internal Revenue Code whereby all employees are participants and have the option to contribute to the plan. In April 1998, the Exchange amended the Savings Plan to provide an enhanced matching contribution for newly hired employees in lieu of eligibility for participation in the qualified defined benefit pension plan. In September 2004, after freezing the future benefit accruals for the qualified defined benefit pension plan, the Exchange amended the Savings Plan to provide for a single matching contribution for all employees. The Exchange's contributions to the Savings Plan were $420,000 and $450,000 for 2004 and 2003, respectively.

The Exchange also has future obligations under deferred compensation arrangements with certain executives, which vest in three years and are unfunded. These obligations total approximately $275,000 and $886,000 as of December 31, 2004 and 2003, respectively, and are included in other current and other liabilities.

# Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

## 11. Other Liabilities *continued*

Other liabilities consisted of the following at December 31:

| | 2004 | 2003 |
|---|---|---|
| Nonqualified pension plans | $ 3,191,000 | $ 2,877,000 |
| Retiree medical plan | 3,475,000 | 3,334,000 |
| Tenant improvement allowance | 2,831,000 | 3,129,000 |
| Excess leased space | 2,901,000 | 1,979,000 |
| Other | 150,000 | 640,000 |
| *Total* | $12,548,000 | $11,959,000 |

The Exchange incurred severance costs related to the elimination of certain officer and staff positions of $846,000 and $1,310,000, during 2004 and 2003, respectively which is included in employee compensation and benefits within the statement of operations. Of this amount, $423,000 and $841,000 remains unpaid at December 31, 2004 and 2003, respectively. The current portions of these amounts are included in other current liabilities and the long-term portions are included in other liabilities above.

## 12. Credit Agreements

The Exchange had a collateralized $10 million line of credit agreement. The terms of the agreement provide for a facility fee and for interest on the outstanding balance at the bank's broker call rate. No amounts were borrowed under this agreement in 2004 and 2003. The Exchange terminated the credit agreement in April 2004.

## 13. Lease Arrangements and Commitments

The Exchange leases facilities and equipment under operating leases expiring at various dates through 2015. Certain leases contain renewal options and escalation clauses.

In December 2000, the Exchange amended and consolidated its space leases under a master leasing arrangement expiring in 2015. The amended lease became effective August 1, 2002. As an incentive for the Exchange to sign the new lease agreement, the lessor provided a tenant improvement allowance of approximately $4,000,000. The Exchange used this allowance to pay for the cost of certain equipment, office furnishings and leasehold improvements. The allowance is included in other current and other liabilities and is being recognized as a reduction of rental expense on a straight-line basis over the term of the new lease or the estimated life of the related asset. The amended lease agreement also includes a contraction option, which under certain terms and conditions, allows the Exchange to reduce its leased space.

During 2004 and 2003, the Exchange determined it had excess office space under its master lease arrangement and accordingly recognized a loss of $1,995,000 in 2004 and $1,860,000 in 2003 applicable to excess space. These losses represent the present value of the excess of expected rental payments under the lease and other costs over anticipated sublease rentals.

In accordance with the sale in 1996 of its former wholly-owned subsidiaries Midwest Securities Trust Company and Midwest Clearing Corporation, the Exchange assigned to the buyer future lease obligations expiring in 2005, which is still in effect under the terms of the new lease agreement.

## Notes to Financial Statements

YEARS ENDED DECEMBER 31, 2004 AND 2003

### 13. Lease Arrangements and Commitments *continued*

Minimum lease commitments, exclusive of taxes, maintenance and other related costs applicable to existing operating leases, at December 31, 2004 were:

| Year | Gross Operating Leases | Sub-Lease Rentals | Net Operating Leases |
|---|---|---|---|
| 2005 | $ 4,609,000 | $ (806,000) | $ 3,803,000 |
| 2006 | 3,785,000 | (105,000) | 3,680,000 |
| 2007 | 3,646,000 | (52,000) | 3,594,000 |
| 2008 | 3,688,000 | — | 3,688,000 |
| 2009 | 3,781,000 | — | 3,781,000 |
| Later years | 22,539,000 | — | 22,539,000 |
| *Total* | $42,048,000 | $ (963,000) | $41,085,000 |

Net rent expense for 2004 and 2003 was $4,742,000 and $5,875,000, respectively. Rent expense includes taxes, maintenance and other costs related to leased property.

### 14. Subsequent Events

On February 9, 2005 (“Effective Date”), the Exchange’s plan of demutualization took effect. Under this plan, the Exchange (formerly a not-for-profit, non-stock corporation owned by its members) became a wholly-owned subsidiary of a holding company, CHX Holdings, Inc. (“CHX Holdings”). CHX Holdings was formed as a for-profit, stock corporation owned by its shareholders, the former member-owners of the Exchange. The demutualization plan was approved by the Exchange’s Board of Governors on August 5, 2004, by its members on November 11, 2004 and by the Securities and Exchange Commission on February 8, 2005. Under the new demutualized structure, the Exchange continues to operate as a national securities exchange, registered with the Securities and Exchange Commission.

As a result of the demutualization, CHX Holdings was authorized to issue 750,000 shares of common stock with a par value of $.01 per share and 25,000 shares of preferred stock with a par value of $.01 per share. On the Effective Date, each former member-owner of the Exchange received 1,000 shares of common stock for each membership that the former member owned as of the Effective Date. CHX Holdings issued 450,000 shares of its common stock because the Exchange had 450 outstanding memberships on the Effective Date. The remaining 300,000 shares of common stock and all of the authorized preferred shares will be available for possible future issuance.

CHX Holdings common stock is a restricted security under the Securities Act of 1933 and is subject to specific ownership, voting and transfer restrictions. Subject to applicable limitations under Delaware law, holders of CHX Holdings common stock are entitled to receive such dividends or other distributions as may be declared by the Board of Directors out of funds legally available for those purposes. As long as the only business of CHX Holdings consists of owning the Exchange, the only source of funds for dividends would be distributions received from the Exchange.

As a result of demutualization, trading privileges on the Exchange are represented by trading permits issued to qualified persons for a periodic fee. All qualified trading members of the Exchange in good standing immediately prior to the demutualization were given the opportunity to obtain trading permits, and the Exchange is authorized to issue additional trading permits to individuals who seek membership and trading privileges.

# Independent Auditors' Report

To the Members of the Chicago Stock Exchange, Inc.:

We have audited the accompanying balance sheets of the Chicago Stock Exchange, Inc. (the "Exchange") as of December 31, 2004 and 2003 and the related statements of operations and of cash flows for each of the years then ended. These financial statements are the responsibility of the Exchange's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 Exchange'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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Chicago Stock Exchange, Inc. as of December 31, 2004 and 2003, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

Chicago, IL
April 15, 2005

## Board of Governors

**Valerie B. Jarrett***
*Chairman*
*Executive Vice President*
The Habitat Company

**Andrew A. Davis***
*Vice Chairman*
*CEO*
Rock Island Securities

**David A. Herron***
*Chief Executive Officer*
The Chicago Stock Exchange, Inc.

**William R. Atwood***
*Executive Director*
Illinois State Board of Investment

**George V. Bayly**
*President*
Whitehall Investors, LLC

**Keith M. Cardoza**
*Director of Equities*
The Boeing Company

**James C. Cotting**
*Retired Chairman*
Navistar International

**Norman L. Eaker**
*General Partner*
Edward Jones

**Tilden S. Engelman**
*President*
Engelman Securities, Inc.

**Louis J. Glavan, III**
*Vice President*
KWS Associates

**David L. Grove***
*CEO*
Dempsey & Company/E*Trade

**Kruno Huitzingh***
*Managing Partner*
In Verity

**David M. Kelly***
*Retired President & CEO*
National Securities
Clearing Corporation

**Michael H. Kerr***
*Partner*
Kirkland & Ellis

**T. Eric Kilcollin***
*Managing Member*
Sanborn Kilcollin Partners, LLC

**Thomas R. Lavery**
*Partner*
ATD/Chicago Securities Group, Ltd.

**Lee M. Mitchell**
*Partner*
Thoma Cressey Equity Partners

**Russell J. Saletta***
*President & Chief Executive Officer*
RJS Investment Ltd.

**James D. Siegel***
*Partner*
BOSS Securities Group, Inc.

**Fred G. Steingraber**
*Chairman*
BoardAdvisors, LLC.

**Mark P. Tellini***
*Senior Vice President*
*Chief of Staff & Strategic Planning Corp.*
*Oversight*
Charles Schwab & Co., Inc.

**Corinne Wood***
*Former Lieutenant Governor*
State of Illinois

* *Demutualized Board*

## Officers

**David A. Herron**
*Chief Executive Officer*

**John K. Kerin**
*Executive Vice President*
*Chief Operating Officer & CTO*

**Stephen A. Brodsky**
*Senior Vice President*
*CFO & Strategic Planning*

**Christopher L. Fairman**
*Senior Vice President*
*Application Development*

**Ellen J. Neely**
*Senior Vice President General Counsel and Secretary*

**David C. Whitcomb, Jr.**
*Senior Vice President*
*Chief Regulatory Officer*

**Larry G. Alfred**
*Vice President Customer Service*

**Kathleen M. Boege**
*Vice President & Associate General Counsel*

**Christopher S. Brown**
*Vice President I/T Operations*

**Robert J. Gibson**
*Vice President Listed Product Trading*

**Krysia E. Jacobs**
*Vice President Technical Services*

**Brian P. Malone**
*Vice President Human Resources*

**Gerald S. Sadowski**
*Vice President National Sales*

## Compensation

The Exchange works to provide appropriate compensation to its directors and officers.

BOARD COMPENSATION — The Exchange's chairman currently receives compensation of $100,000 per year. The Exchange's vice chairman currently receives compensation of $50,000 per year. The Exchange's public directors receive a stipend of $1,000 for each quarter that they serve on the Board, along with $2,000 for each Board meeting that they attend. Public directors also receive $500 for each committee meeting that they attend ($600, if the director chairs the committee). Participant directors do not receive a quarterly stipend and receive only $800 for each Board meeting that they attend. With the exception of one committee, participant directors do not receive compensation for committee service. The Exchange pays reasonable travel costs associated with director attendance at Board and committee meetings.

OFFICER COMPENSATION — The Exchange does not normally disclose, to the public, the compensation paid to its staff. Because of the focus on the compensation paid to market officials, however, the Exchange believes it is important to provide information about the compensation paid to its highest paid officer. Mr. David A. Herron, the Exchange's Chief Executive Officer, earned a base salary of $450,000 in 2004 and participated in benefit programs generally made available to Exchange staff. He was not awarded a bonus or other deferred compensation with respect to 2004.

CHICAGO STOCK EXCHANGE, INC.

~

ONE FINANCIAL PLACE
440 SOUTH LASALLE STREET
CHICAGO,ILLINOIS 60605-1070
WWW.CHX.COM
312.663.2222
MARKETING@CHX.COM