

ESPEED INC  
Form 10-K/A  
August 23, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-K/A**

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**FOR ANNUAL AND TRANSITION REPORTS PURSUANT TO SECTION 13 OR 15(d)**  
**OF THE SECURITIES EXCHANGE ACT OF 1934**

(Mark One)

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

For the fiscal year ended December 31, 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 0-28191

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**eSpeed<sup>®</sup>, Inc.**

(Exact Name of Registrant as Specified in Its Charter)

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Delaware  
(State or Other Jurisdiction)

13-4063515  
(I.R.S. Employer)

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of Incorporation)

Identification No.)

110 East 59<sup>th</sup> Street, New York, NY  
(Address of Principal Executive Offices)

10022  
(Zip Code)

(212) 610-2200

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

<b>Title of Each Class</b>	<b>Name of Each Exchange on Which Registered</b>
Class A Common Stock, \$0.01 par value	The NASDAQ Stock Market LLC

Securities registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K/A or any amendment to this Form 10-K/A.

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.

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

The aggregate market value of voting common equity held by non-affiliates of the registrant, based upon the closing price of the Class A common stock on June 30, 2006 as reported on NASDAQ, was approximately \$221,097,102.

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

<b>Class</b>	<b>Outstanding at March 13, 2007</b>
Class A Common Stock, par value \$0.01 per share	29,930,696 shares
Class B Common Stock, par value \$0.01 per share	20,497,800 shares

DOCUMENTS INCORPORATED BY REFERENCE.

None



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eSPEED, INC.

**2006 FORM 10-K/A ANNUAL REPORT**

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***Forward-Looking Information Safe Harbor Statement***

**Discussion of Forward-Looking Statements**

The information in this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as may, will, should, estimates, predicts, potential, continue, strategy, believes, anticipate, intends and similar expressions are intended to identify forward-looking statements.

On May 29, 2007, eSpeed Inc., (the Company or eSpeed ) announced that it had entered into an Agreement and Plan of Merger, dated as of May 29, 2007, with BGC Partners, Inc. ( BGC ); Cantor Fitzgerald, L.P. ( Cantor ); BGC Partners, L.P., a Delaware limited partnership; BGC Global Holdings, L.P., a Cayman Islands exempted limited partnership; and BGC Holdings, L.P., a Delaware limited partnership pursuant to which eSpeed will acquire BGC through a merger of BGC with and into eSpeed. For more information, see eSpeed s Report on Form 8-K dated May 29, 2007.

The actual results of eSpeed, BGC or the combined company in the merger ( we , our , or the combined company ) and the outcome and timing of certain events may differ significantly from the expectations discussed in the forward-looking statements. Factors that might cause or contribute to such a discrepancy for eSpeed, BGC and/or the combined company include, but are not limited to, our relationship with Cantor and its affiliates and any related conflicts of interests, competition for and retention of brokers and other managers and key employees, pricing and commissions and market position with respect to any of our products, and that of the our respective competitors, the effect of industry concentration and consolidation, and market conditions, including trading volume and volatility, as well as economic or geopolitical conditions or uncertainties. Results may also be impacted by the extensive regulation of our respective businesses and risks relating to compliance matters, as well as factors related to specific transactions or series of transactions, including credit, performance and unmatched principal risk as well as counterparty failure. Factors may also include the costs and expenses of developing, maintaining and protecting intellectual property, including judgments or settlements paid or received in connection with intellectual property or employment or other litigation and their related costs, and certain financial risks, including the possibility of future losses and negative cash flow from operations, risks of obtaining financing and risks of the resulting leverage, as well as interest and currency rate fluctuations.

Discrepancies may also result from such factors as the ability to enter new markets or develop new products, trading desks, marketplaces or services and to induce customers to use these products, trading desks, marketplaces or services, to secure and maintain market share, to enter into marketing and strategic alliances, and other transactions, including acquisitions, dispositions, reorganizations, partnering opportunities, and joint ventures, and the integration of any completed transactions, to hire new personnel, to expand the use of technology for screen-assisted, voice-assisted and fully electronic trading and to effectively manage any growth that may be achieved. Results are also subject to risks relating to the proposed merger and separation of the BGC businesses and the relationship between the various entities, financial reporting, accounting and internal control factors, including identification of material weaknesses in our internal controls, our ability to prepare historical and pro forma financial statements and reports in a timely manner, and other factors, including those that are discussed under Risk Factors in this Annual Report on Form 10-K/A for the year ended December 31, 2006 filed with the Securities and Exchange Commission (the SEC ) on August 22, 2007 and BGC s Registration Statement on Form S-1 filed with the SEC on February 8, 2007 (Registration No. 333-140531) to the extent applicable.

We believe that all forward-looking statements are based upon reasonable assumptions when made. However, we caution that it is impossible to predict actual results or outcomes or the effects of risks, uncertainties or other factors on anticipated results or outcomes and that accordingly you should not place undue reliance on these statements. Forward-looking statements speak only as of the date when made and we undertake no obligation to update these statements in light of subsequent events or developments.

**EXPLANATORY NOTE**

Subsequent to the issuance of the Company s consolidated financial statements for the year ended December 31, 2006, management became aware that certain revenues and expenses related to a portion of the development of related party software covered under the Company s Joint Services Agreement (the JSA ) with Cantor required restatement. The Company had accounted for certain fees paid by related parties for software development as revenue in the period when the cash was received. The Company has now concluded that some of these paid fees should have been deferred and recognized ratably over the future period when such software will be used to provide services to Cantor. The restatement correction reduces revenue from current periods, thereby creating a deferred revenue liability. The restatement also corrects the amortization expense that was recorded in connection with the determination of the period of benefit provided by the developed software. See Note 21, Restatement, of Notes to the Consolidated Financial Statements for a detailed discussion of the effects of the restatement.

## Edgar Filing: ESPEED INC - Form 10-K/A

The Company is filing this Amendment to its Annual Report on Form 10-K for the year ended December 31, 2006 (the Amended Form 10-K ) to reflect the restatement of the Company's audited financial statements for the years ended December 31, 2006, 2005 and 2004, the financial information in the Selected Financial Data for the five-year period ended December 31, 2006, the unaudited selected quarterly financial information for each quarter in the years ended December 31, 2006 and 2005, and related financial information and disclosures originally filed with the SEC on Form 10-K on March 15, 2007 (the Original Filing ). This Amended Form 10-K amends and restates Item 1A of Part I, Items 6, 7, 8, and 9A of Part II, and Item 15 of Part IV of the Original Filing. These Items have been amended to reflect the effects of the restatement and unless otherwise indicated, have not been updated to reflect other events occurring after the filing of the Original Filing. Following the filing of this Amended Form 10-K, the Company will file an amended Quarterly Report on Form 10-Q for the quarter ended March 31, 2007. The Company has not amended, and does not intend to amend, any of its other previously filed reports for the periods affected by the restatement. The Company's previously issued financial statements included in those reports for the years ended December 31, 1999 through 2006 and for the quarter ended March 31, 2007 should no longer be relied upon.

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PART I

**ITEM 1. BUSINESS  
OVERVIEW**

*Throughout this document eSpeed, Inc. will be referred to as eSpeed and, together with its subsidiaries, as the Company, we, us or our.*

We are a leader in developing and deploying electronic marketplaces and related trading technology that offers traders access to the most efficient, innovative and neutral financial markets in the world. We provide an array of financial technology products which assist customers in managing market risk. We operate multiple buyer, multiple seller real-time electronic marketplaces for the global capital markets, including the world's largest government bond markets, the world's largest foreign exchange markets, and other financial marketplaces, which may be accessed through fully electronic transactions for some products or through an integrated hybrid voice-assisted network accessed by voice-brokers. Our suite of marketplace tools provides end-to-end transaction solutions for the purchase and sale of financial products over our global private network or via the Internet. Our neutral platform, reliable network, straight-through processing and proven solutions make us a trusted source for fully electronic and integrated hybrid voice-assisted trading at the world's largest fixed income and foreign exchange trading firms, major exchanges and leading equities trading firms in the world.

We commenced operations in March 1999 as a division of Cantor Fitzgerald Securities, a subsidiary of Cantor Fitzgerald, L.P. (Cantor). Our initial focus was the global government bond markets of the world, specifically in the U.S., Europe, Canada and Japan. Our relationships with Cantor, and with BGC Partners, L.P. (BGC), a subsidiary of Cantor, formed in connection with a reorganization of Cantor's inter-dealer brokerage business in 2004, and affiliates of BGC, have enabled us to become an innovator in what today we consider our core electronic marketplaces, the government bond markets of the world. Cantor is a leading financial services provider that offers an array of financial products and services in the equity, fixed income and foreign exchange capital markets. BGC is a leading global inter-dealer broker to wholesale fixed income, interest rate, and foreign exchange and derivative markets worldwide. Our goal is to offer an electronic trading platform for a full range of financial products currently traded in today's global capital markets, which includes fully electronic trading of wholesale fixed income, foreign exchange, futures, options and equities and integrated hybrid voice-assisted trading in treasury-spreads, off-the-run and when issued U.S. Treasury securities, repurchase agreements and U.S. Government Agency Securities, as well as other products. Our relationships with Cantor and BGC are critical to our meeting that goal, especially as it relates to integrated hybrid voice-assisted trading.

Our products promote trading efficiency. They enable market participants to transact business more quickly, more effectively and at lower cost than with traditional markets and methods. Our systems were built to support multiple interactive marketplaces, in a completely neutral, efficient and real-time environment. In 2006, we processed approximately 9.1 million electronic transactions, totaling more than \$97.9 trillion of notional transactional volume. Our customers include the largest fixed income, foreign exchange and equities trading firms and leading exchanges in the world. We have offices in the U.S., U.K. and Asia that collectively can transact trading 24 hours a day, around the world. In the course of conducting their core businesses, our customers are required to manage substantial market risk. Night and day, they trust our solutions to assist them in this critical function. We believe we offer among the most robust, large-scale, instantaneous and reliable transaction processing systems in the world. Our global private network permits market participants to view information and execute transactions in milliseconds.

We are innovators. Our proprietary software provides an end-to-end solution, including unique front-end applications, customized order and trade input devices, proprietary transaction matching and processing engines, credit and risk management tools and back-office and clearance systems, enabling straight-through processing. We also leverage our electronic marketplace expertise and reputation to sell software products and services directly to participants in these marketplaces.

We are neutral in the financial markets. We neither act as a participant in customer transactions, nor do we risk our own capital in transactions or extend credit to market participants. Our revenues consist primarily of fixed payments, transaction fees and licensing fees, and we market our services to customers, partners and prospects.

Our objective is to be the leading provider of trading and market risk management technology and interactive marketplaces for the world's capital markets, where we believe there is a substantial opportunity for both fully electronic and integrated hybrid voice-assisted trading. Specifically, we believe we are well-positioned to take advantage of the attractive opportunities currently presented throughout our core fixed income market, as well as the foreign exchange, futures and options markets of the world. We believe that the scalability and extendibility of our eSpeed suite of products, and our relationships with Cantor and BGC, enable us to enter new markets and distribute products and services quickly, cost effectively and seamlessly.





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### **THE INDUSTRY**

Historically, voice-only trading of over-the-counter financial and nonfinancial products has been an inefficient process for the most liquid benchmark securities. Buying, selling or trading activity is traditionally effected through (i) a central physical location, like a trading pit or auction house, where market participants have to access the market through this central location or its members; (ii) a bilateral arrangement between a buyer or seller; or (iii) several layers of middlemen and salespersons who assist in handling orders. Each of these approaches is labor and time intensive, which adds to the direct and indirect cost of the product being bought or sold.

Traditional voice-only over-the-counter financial markets and methods facilitate trading in less liquid securities where transaction risk is significant. Nevertheless, they have the following significant shortcomings: information leakage; limited direct access and, therefore, inefficient pricing; high transaction costs and slow execution due to the number of people involved in a traditional voice-only transaction; significant expense incurred in manual processing, confirming and clearing processes; and compliance and regulatory risk associated with traditional voice-only transactions and non-automated audit trails. While the value added by voice facilitation outweighs these disadvantages in many less liquid instruments and more complex transactions, these shortcomings are unacceptable to many participants in the markets for the most liquid and high volume benchmark securities. Whereas in less liquid markets the market, background and negotiation provided by a voice broker can assist in facilitating a trade that might not otherwise occur, in the most liquid securities there is no information or background necessary other than the intention of a market participant to offer a trade. In addition, traditional financial markets have difficulty in implementing computer-based trading of liquid securities, especially those computer-based systems designed to automatically and simultaneously execute multiple trades in different, but related products. Additional inefficiencies of traditional transaction execution include lack of real-time price information, small disparate groups of interested buyers and sellers, limited liquidity and problems associated with executing trades as market prices change. After a buy or sell order is executed, there are the additional tasks of recording, accounting, tracking, delivering and financially settling the transaction. Each of these tasks, if done manually, can add potential cost and error to the process as additional participants or systems enter the transaction cycle. As a market matures and benchmark securities appear, these costs and inefficiencies inhibit a market from realizing its full potential.

Electronic marketplaces have emerged as effective means of conducting transactions and creating markets. In an electronic marketplace, substantially all of the participants' actions are facilitated through an electronic medium, such as a private electronic network or over the Internet, which reduces the need for actual face-to-face or voice-to-voice participant interaction to those functions where people provide the greatest value, thereby reducing the inefficiencies inherent in a traditional voice-only brokered market.

Electronic marketplaces have proven that the inefficiencies of traditional voice-only brokered markets and methods have inhibited participant access to many potentially profitable trading opportunities. The elimination of these inefficiencies has opened access to these opportunities, increasing trading profits, investment returns and market volumes, and made possible creation of new financial products and strategies that have further contributed to increased market volumes. These increased trading volumes have in turn driven increased demand for newer, ever-more sophisticated financial technology products.

Many financial exchanges worldwide, including certain exchanges in the U.S., France, Canada, Germany, Japan, Sweden, Switzerland and the United Kingdom, are now partially or completely electronic. Additionally, even in markets for less commoditized products where customers place orders through a voice-broker who implements a transaction electronically, companies will benefit from liquidity, pricing, robust interactive trading, post-trade processing and other services of our marketplace technology. Further, we believe that market participants will seek to outsource customized solutions for the electronic distribution of their products to avoid the difficulty and cost of developing and maintaining their own electronic solutions, and to improve the quality and reliability of these solutions.

### **OUR SOLUTION**

Our electronic marketplace end-to-end solution includes real-time and auction-based transaction processing, credit and risk management tools and back-end processing and billing systems, all accessible through our privately managed global high-speed data network and over the Internet. Because of the scale and adaptability of our system, our products have applications across a broad range of customers, market participants, industries, and marketplaces, including any global financial marketplace involving multiple buyers and multiple sellers. In addition, we license our software to provide a complete outsourced solution to our customers, enabling them to distribute their branded products to their customers through online offerings and auctions, including private and reverse auctions, and request-for-quote capabilities. Our products enable market participants to transact business and manage market risk instantaneously, more effectively and at lower cost than traditional voice-only financial markets methods.

Our business model and affiliated relationships with voice-broker BGC and Freedom International Brokerage Company ( Freedom ) provide us with a significant long-term pipeline of our product opportunity, both in terms of electronic transaction volume and increased revenues across our product and service offerings, as a marketplace for a particular product matures from



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telephones with computer assistance and migrates to integrated hybrid voice-assisted trading and eventual fully electronic trading. Historically, new markets have initially tended to trade by voice alone. As volumes improve and the structure and characteristics of the market standardize over time, its potential to leverage technology increases. The first stage of this migration occurs when open outcry trading provided by an affiliated voice brokerage is supplemented with a market data screen, and for which we receive 2.5% of related trading revenue. The second stage is the migration of these affiliated voice brokers to the use of keyboards and computers to keep track of increasing volumes of orders and to match trades. This voice-assisted brokerage earns us 7% of related trading revenue. The third stage occurs with the appearance of benchmarks and highly liquid markets, which over time should cause customers to migrate towards fully electronic trading. This means that the trading is done by the customers themselves, whether by keyboards and computers, or directly by computers themselves. For some products, the transition to fully electronic trading occurs from an integrated marketplace in which one pool of liquidity is accessed simultaneously by the customer through the keyboard, by a computer program or by a voice broker over a keyboard at the request of a customer. Fully electronic transactions that have migrated through these stages generally provide us 65% of related trading revenue, or 50% of net related trading revenue in cases of products which are in the process of migrating to fully electronic marketplaces from an integrated marketplace. The pace at which individual markets will migrate along our affiliate pipeline will vary among the different types of instruments and based on the nature of the marketplace.

Our solution is built on three core principles: speed, simplicity and service. We provide products that are designed to be the market leader in terms of their speed of execution. Integral to our mission are solutions that are easy to understand and easy to use by our customers. Our customers trust our solutions to assist them in managing substantial market risk. We repay that trust with our focus on superior customer service across all facets of our business.

We expect to continue to improve our technology through additional investment in our core fixed income products, expanding into new markets and developing technology to improve our system and our trading environment. In 2006, we continued to upgrade our system, making it faster and easier to use, and added senior sales staff to promote our products, including a renewed focus on our foreign exchange product. Throughout our business, our focus is to provide our customers with the tailored tools they need as our products migrate through our pipeline of opportunity.

## **OUR MARKET FOCUS**

We focus our business primarily on the wholesale fixed income business, as well as target opportunities in markets such as foreign exchange, futures and options. There has been a significant move towards the conversion of traditional open outcry markets to electronic trading. Significant business opportunities have arisen for the provision of front-end risk management and routing solutions that provide access to electronic marketplaces. We believe that there is significant opportunity in the continued conversion of these markets to fully electronic networks, such as our own.

**Wholesale fixed income.** The global fixed income market is one of the largest securities markets in the world based on total bond issuance and the amount of debt outstanding. The Securities and Financial Markets Association (the Association) estimates that for the first 9 months of 2006, total long-term bond issuance was over \$4.3 trillion in the U.S. alone and there were approximately \$26.7 trillion of fixed income securities outstanding as of September 30, 2006. The Federal Reserve Bank of New York (the New York Fed) reports that approximately \$526 billion a day in trading took place among the primary dealers and their customers in the U.S. Treasury market in 2006 compared to \$555 billion in 2005. These estimates of average daily volume exclude trades of U.S. Treasury securities executed by non-primary dealers and other market participants who do not report their figures to the New York Fed. Such transactions have become an increasing percentage of eSpeed's fully electronic trading volume. We predict that by the end of 2008, the U.S. Treasury market, including trades not reported to the New York Fed, will double in size from its 2005 levels, reaching approximately \$1 trillion in average daily volume by the end of 2008.

**Foreign exchange.** The trading of foreign exchange is one of the largest markets in the world and continues to grow rapidly. Industry experts and market participants forecast that average daily volume will soon pass \$3 trillion per day, up from the \$1.9 trillion per day reported three years ago by the Bank for International Settlements in its last Triennial Survey in April 2004. Growth is due in large part to the interest in foreign exchange as an asset class, resulting in increased activity from asset managers, hedge funds, commodity trading advisors and banks.

**Futures and options.** Futures and options trading is a leading financial activity throughout the world, with contracts traded on a wide variety of financial instruments, commodities and indexes. According to the Futures Industry Association, approximately 9.9 billion, futures and options contracts were traded in the global futures and options markets in 2005, while over 5.9 billion were traded in the first six months of 2006. According to the International Swaps and Derivatives Association, the global market for interest rate swaps, interest rate options and currency swaps had over \$283.2 trillion in notional value outstanding as of June 30, 2006.

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### **OUR FINANCIAL MARKETS SOLUTION**

Our products cover various financial markets, including a network for trading U.S. Treasury securities, European, Japanese and Canadian government bonds, interest rate swaps, futures, options, foreign exchange, repurchase agreements, U.S. Agency securities, U.S. Treasury swaps, Euro bonds and basis trades. Cantor has historically been a major facilitator and, in some cases, provider of liquidity in numerous financial products through its offices in the U.S., Canada, Europe, Asia and Australia. In August 2004, Cantor announced the restructuring of its inter-dealer brokerage business, renaming it BGC, in honor of B. Gerald Cantor, Cantor's founder and a pioneer in screen brokerage and fixed income market data products. BGC provides integrated voice and electronic execution and other brokerage services to many of the world's largest and most creditworthy banks that regularly trade in capital markets, brokerage houses and investment banks for a broad range of global financial products, including fixed income securities, foreign exchange, equity derivatives, credit derivatives, futures, structured products and other instruments, as well as market data products for selected financial instruments. In May 2005, BGC acquired voice broker Maxcor Financial Group Inc. and its subsidiaries, including EuroBrokers Inc. and has grown its business substantially since then through a number of global acquisitions and hires. In February 2007, BGC filed a registration statement with the Securities and Exchange Commission in connection with its proposed initial public offering of shares of its Class A common stock. Our eSpeed system provides the only electronic means of access to Cantor's and BGC's marketplaces. Through our affiliation with Freedom, eSpeed also powers the electronic platform of Freedom, the leading interdealer broker of Canadian fixed income and other capital markets products.

Our private electronic network for wholesale financial markets is connected to the largest financial institutions worldwide. We have installed in the offices of our existing customer base the technology infrastructure necessary to provide price information and trade execution on an instantaneous basis in a broad range of securities and financial instruments. We believe our eSpeed portfolio of products enables us to introduce and distribute a broad mix of financial products and services quickly, efficiently, and at a lower cost than traditional methods.

With our financial technology, participants in hybrid marketplaces may either electronically execute trades themselves or call our affiliated brokers, who then input trade orders into an integrated hybrid marketplace for them. In our fully electronic marketplace, all stages of the trade occur electronically. The participant inputs buy or sell order instructions directly into our electronic trading system using our software, a web-browser or electronically through an application programming interface or other software. Our system provides to the participant on-screen confirmation that the participant's order has been accepted. The system normally responds to all orders in less than 300 milliseconds. Simultaneously, an electronic confirmation is typically sent to the participant's back office and risk system, providing straight-through processing and enabling risk management capabilities for the participant. Our U.S. Government Securities marketplace is fully electronic, and we have also established fully electronic solutions for our newer foreign exchange and futures and options businesses, as well as for BGC-branded U.S. dollar repurchase obligations (repo) and European credit default swap trading platforms.

We see opportunities to expand our business by working more closely with our affiliated voice brokers, and by licensing our technology to other voice brokers and financial services firms in addition to Cantor and BGC, as well as to exchanges and other financial institutions.

### **eSPEED PRODUCTS AND SERVICES FOUNDATION AND GROWTH BUSINESSES**

We organize our business into two main categories. First, we focus on the business lines that create a solid foundation on which we can build. Electronic trading of government bonds is the first building block in our foundation. Relationships with voice-brokerage trading firms such as BGC and Freedom, our strong intellectual property portfolio and Software Solutions services make up the remainder of our foundation businesses. Second, we look to areas of opportunity from which we expect to grow, including through the introduction of new products. We are focusing on generating increased volume in the computer-based trading of U.S. Treasury securities, expanding further into the fully electronic foreign exchange, futures, options, U.S. dollar repo, and European credit default swaps markets, as well as developing innovative trading tools that enhance eSpeed's platform and attract traders to our screens.

#### **Foundation Businesses:**

##### ***Government Bonds***

Currently, most of our revenues derive from fully electronic transactions in the government bond markets in which participants electronically execute trades using a keyboard, mouse or computer program. These include U.S., European, Canadian and Japanese government securities, primarily concentrated in U.S. Treasury securities. Our full-service eSpeed system, combining all of our proprietary software and our global high-speed private network, currently operates in some of the largest and most complex government bond marketplaces in the world. It is designed to be extendible to any multiple-buyer, multiple-seller marketplace and



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can support massive liquidity and fluctuation in many markets. Our customers in these markets include the largest financial institutions in the world. These customers access our eSpeed system primarily through our global high-speed private network. In addition, the system for these products is also available over the Internet. Our eSpeed system enables us to operate an integrated network with the inherent scale and leverage to engage in electronic trading in multiple products, marketplaces and market structures on a global basis and is a comprehensive platform providing volume, access, speed of execution and ease of use.

### ***Voice-Assisted Trading***

A substantial portion of our revenues is also derived from integrated hybrid voice-assisted trading. A voice-assisted trade is executed in substantially the same manner as an electronic trade, except that the customer participant telephones a broker, who then inputs the participant's order into our electronic marketplace system. An order may be matched with other voice assisted orders and/or on some systems with orders electronically submitted by other customers. This integrated hybrid voice-assisted trading model leverages a broker's skill and market knowledge but also serves as a pipeline for potential future fully electronic transactions.

In 2001, we entered the Canadian fixed income market through our investment in and technology agreement with Freedom, the leading Canadian interdealer broker of fixed income products and other capital products. In addition, BGC provides voice brokerage services to the wholesale fixed income, interest rate and foreign exchange and derivative markets worldwide leveraging eSpeed technology. In May 2005, BGC acquired the Euro Brokers voice brokerage network and ETC Pollack, a leading French interdealer broker. In November 2006, BGC acquired Aurel Leven, another leading independent French interdealer broker in the equity, equity derivatives and fixed income markets and, in December 2006, BGC acquired AS Menkul, an established broker in Turkey. All of these acquisitions add to the pipeline of potential hybrid voice-assisted transactions on eSpeed's platforms.

Relationships with leading interdealer brokers like BGC and Freedom allow us to tap into the enormous opportunities in voice-brokered businesses in which less commoditized products are traded. Our technology enables voice-brokers to provide superior customer service using pricing and trade history databases, through analytics, to price distribution. Through integrated hybrid voice-assisted trading, we see opportunities to increase our presence in the world's voice-brokered markets in products like Treasury spreads, off-the-run Treasury securities, when-issued U.S. Treasury securities, U.S. Government Agency securities and credit and fixed income derivative products.

Treasury spreads are financial products (e.g. interest rate swaps) that trade in relation to U.S. Treasury on-the-run benchmarks, the most recently issued Treasury securities that are the standard trading instruments in the bond market. A Treasury spread is derived from the price or yield difference between the financial product being traded and the benchmark.

Off-the-run securities are Treasury bonds and notes that were formerly on-the-run benchmarks but have been supplanted by more recently issued securities. When a new on-the-run benchmark is issued, the current on-the-run becomes an off-the-run.

When-issued U.S. Treasury securities represent new issues that will be created through the auction process and will become the new on-the-run benchmarks. A when-issued instrument has been authorized and may be traded although it has not yet been issued.

A U.S. Government Agency security is debt issued by a Government Sponsored Enterprise, such as the Federal Home Loan Bank ( FHLB ), Freddie Mac, Fannie Mae, TVA and TAPS. U.S. Agencies pay interest and are believed to have little or no credit risk, although they are not backed by the U.S. Government.

Treasury Inflation Protection Securities ( TIPS ) are debt issued by the U.S. Treasury that offer protection against inflation because their principal and interest payments are linked to inflation.

In addition, our voice-broker customers are providing opportunities to enter new markets for voice-brokered products, such as interest rate swaps. Launched in Europe in December 2003, our interest rate swaps product provides an electronic solution for voice-assisted trading of benchmark one-year to 10-year U.S. dollar- and Euro-denominated products, which are the most high-volume, commodity-like products in the swaps market. By providing straight-through processing and targeting the inter-bank market only, we have created a market where the largest banks can do business with each other without volume or credit limitations. In 2006, we added new spreading functionality and linkage with

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BGC's voice brokers in order to encourage usage of our interest rate swaps products.

It is also likely that over time more of the traditional voice-brokered products, such as emerging market debt, credit default swaps, corporate bonds, repurchase agreements and interest rate swaps, will fit the hybrid voice-assisted model. In December 2005, BGC announced the first integrated hybrid voice-assisted and electronic U.S. dollar repo trading platform for primary dealers powered by eSpeed's technology. This BGC repo platform allows primary dealers to execute and process overnight and term specials, Treasury bills and off-the-run Treasury repo trades either through fully electronically or through voice-assisted trading.

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During 2006, we developed a new BGC Trader application for credit default swaps and corporate bonds based on customer feedback and individually tailored market preferences. Further extension of this new platform is expected through 2007 into other voice/electronic hybrid products such as credit default swaps, index tranches and options.

### ***Intellectual Property Licensing***

We have a strong intellectual property portfolio, and we are committed to adding to its value as we continue to develop more proprietary technology, as well as to licensing our technology and defending and protecting our technology from time to time through litigation. Patented innovations to our technology allow us to differentiate our product offerings, create barriers to entry, and improve our products and services. Our Wagner patent with respect to futures trading expired in February 2007 but provided us with a significant source of licensing revenue until that time. Our patent portfolio is growing and consists of numerous patents and patent applications relating to our core business and relating to other businesses. See Our Intellectual Property. Certain of our intellectual property is the subject of litigation. See Legal Proceedings.

With respect to our patents and other intellectual property, we entered into long-term licensing agreements with the InterContinentalExchange, Inc. ( ICE ), the Chicago Mercantile Exchange, Inc. ( CME ), the Board of Trade of the City of Chicago Inc. ( CBOT ), the New York Mercantile Exchange Inc. ( NYMEX ) and the New York Board of Trade ( NYBOT ) with respect to our Wagner patent, which provided revenue to us throughout 2006 and expired in February 2007.

### ***eSpeed Software Solutions<sup>SM</sup>***

Through our services agreements and our eSpeed Software Solutions business, we provide customized software to broaden distribution capabilities and provide electronic solutions to both related and unrelated parties. In addition to providing technology infrastructure to related parties such as Cantor, BGC and Freedom, eSpeed Software Solutions leverages our global infrastructure, our software and systems, our portfolio of intellectual property and our electronic trading expertise to provide unrelated customers with electronic marketplaces and exchanges and real-time auctions to enhance debt issuance and to customize trading interfaces. eSpeed Software Solutions takes advantage of the scalability, flexibility and functionality of our eSpeed system to enable our customers to distribute their branded products to their customers through online offerings and auctions, including private and reverse auctions, via our trading platform and global network. Using eSpeed Software Solutions, customers are able to develop a marketplace, trade with their customers, issue debt, trade odd lots, access program trading interfaces and access our network and our intellectual property.

In addition to long-term licensing agreements, we have signed Software Solutions agreements with a number of U.S. and international enterprises, including the following:

For the World Bank, eSpeed's trading engine and network connect the World Bank to its dealer customers anonymously through our Internet-based, real-time auction platform. This system was released in June 2003 and has handled nearly \$13 billion of the World Bank's interest rate swap volume to date.

The Federal Home Loan Bank ( FHLB ) is a U.S. Government-sponsored enterprise and one of the largest issuers in the global short-term securities market. Our electronic auction-based technology has powered the FHLB's primary discount note auctions since August 2002.

### **Growth Businesses and New Products:**

#### ***Computer-Based Program Trading in the U.S. Treasury Market***

In recent years, the growth of electronic trading in the U.S. Treasury market has contributed to an explosion in trading volume. We believe another wave of volume growth is beginning to be driven by computer-based trading. Computer-based trading, which includes program trading, Black Box Trading, and algorithmic trading, is the use of sophisticated computer programs to manage and automatically execute securities trades from mathematical and risk formulas and the relationships among various securities and markets. These trades tend to be in high frequency. eSpeed's trading platform is well-suited for this type of quantitative trading. We are enhancing our trading platform speeds and system tools to accommodate the needs of computer-based traders, as well as the new needs computerized trading creates among other market participants. As computerized trading becomes more wide-spread, we believe that we will be well positioned to capture a portion of the increase in volumes in the market.



*Trading of Other Fully Electronic Financial Products*

We have identified opportunities to leverage our position in the global government bond markets into a variety of other key financial markets and are actively developing technology and initiatives for trading less-established products. For example, we have

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rolled out technology for trading in foreign exchange along with, U.S. dollar repo, and European credit default swaps for use with BGC, and for order routing in the futures markets. We invested in these businesses by adding dedicated, experienced sales professionals to focus on these products by penetrating new markets and enhancing customer service. In 2006 and into 2007, we are continuing to refine our sales and service efforts in order to develop more demand for these new products with increased usage of our spreading tools, to translate liquidity in one market to another.

**Foreign Exchange.** Launched in 2003, our foreign exchange product (eSpeed FX) was the first to introduce totally anonymous trading on a central counterparty to the professional trading community. This product offers global, scalable and real-time trading in all major CLS<sup>®</sup> currencies.

**Futures and Options.** In December 2002, we entered into an agreement with the CBOT to distribute futures products through our eSpeed system, providing customers with the ability to trade both cash and futures in one neutral, fully electronic marketplace. By routing CBOT futures trades over our existing eSpeed network and providing front-end integration to our customers, cash traders and the CBOT's futures traders have direct, instantaneous access to both markets. In 2004, our eSpeed system was fully integrated into the CBOT and EUREX and in 2005 to the CME, giving users of these exchanges direct access through eSpeed's platform. This combination of the cash and futures markets is a significant advantage to all traders accessing eSpeed's platform. This integration extends eSpeed's exposure and access to additional U.S. and European traders and has the potential to create greater crossover transactions between the cash and futures markets. In December 2004, under the agreement with NYBOT, we became the sole owner of the Cantor Financial Futures Exchange and the Commodity Futures Clearing Corporation of New York. Additionally, we agreed that NYBOT will provide processing services for futures contracts or options on futures contracts listed on the Cantor Financial Futures Exchange or other exchanges designated by us. In October 2004, we acquired United Kingdom-based ITSEcco Holdings Limited and its subsidiaries (collectively, ECCO), a highly specialized software developer focused on the financial markets. ECCO provides a multi-asset class user interface for electronic trading incorporating automated cross market spreading functionality. During 2005, the ECCO product was interfaced with the eSpeed platform, facilitating the integrated trading of futures and eSpeed's U.S. Treasury and foreign exchange markets. In addition to its offering to eSpeed users, ECCO also markets its product directly to customers of major futures exchanges around the world both in the form of a packaged software solution and as a hosted service.

**BGC-Branded Repos and European Credit Default Swaps.** In December 2005, BGC announced the first integrated hybrid voice-assisted U.S. Dollar repo trading platform for the primary dealer community, powered by eSpeed's technology, which was launched during the first half of 2006. The integrated platform offers a wide range of U.S. Treasury repo products that can be either electronically traded directly by the customer or managed through a voice-assisted broker. In the second half of 2006, eSpeed developed a new customer friendly user interface for BGC's credit businesses to cover single name credit default swaps, indices and bonds with credit default swaps (CDS) tranches and options were added in the first quarter of 2007.

**Equities.** In November 2003, we moved into the equities market with the launch of eSpeed Equities, an order-routing system for the institutional equities market. eSpeed Equities provides an order routing and execution platform that affords equity market participants multiple points of entry and simultaneous electronic access to the world's largest exchanges, market makers and ECNs as well as intelligent order handling capabilities, such that traders can automatically access the best prices available at multiple venues with a single order. On January 3, 2007, we announced the planned spin-off of Aqua, a new business whose purpose is to bring new block trading liquidity to the global equities markets. Kevin Foley, our former President, has been named President and CEO of Aqua. eSpeed and Cantor will collectively contribute financial, professional, and technology assets to the new business, which will be owned 51% by Cantor and 49% by eSpeed, subject to NASD approval.

## **OUR STRATEGY**

Our objective is to be the world's leading provider of fully electronic and integrated hybrid voice-assisted marketplaces and related software solutions to a broad range of financial marketplaces. Our strategy includes the following key elements:

### **Expand system functionality and develop new products, software and services for our existing financial markets**

We plan to continue to expand the types of financial and other products traded in our marketplaces, both in the U.S. and abroad. We are currently focused on fixed income, as well as developing our sales in foreign exchange, futures, options and swaps. For example, we believe that our foreign exchange product has the potential to offer new efficiencies to the foreign exchange markets. As another example, we saw increased usage of our U.S. Treasuries yield curve swaps product through 2006, enhanced by our TOPSpeed spreading engine to execute such spread trades via their component U.S. Treasury benchmark markets. We plan, over time, to seek to serve additional marketplaces that can benefit from more efficient, centralized, electronic trading facilities. Our goal is to include in our electronic marketplaces a broad range of the most commodity-like financial products that are currently traded in today's capital markets worldwide, with particular focus on those products currently traded by our affiliated voice brokerages as they exhibit a higher velocity of trading. We believe we are well positioned to leverage the significant costs and efforts that have been incurred developing our eSpeed system to create electronic markets in a wide range of such financial

products.

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### **Develop and enhance integrated hybrid voice-assisted marketplaces**

In markets that are less commodity-based, we have developed and will continue to develop relationships with voice brokers, including our affiliates, BGC and Freedom, to provide voice-assisted brokerage services to their marketplaces. We plan to capitalize on and develop these relationships to increase our presence in the world's integrated hybrid voice-brokered markets by incentivizing voice brokers to use our electronic system for multiple products and in additional products such as Treasury spreads, off-the-run Treasury securities, when issued Treasury securities, U.S. Government Agency securities, U.S. Treasury bills, U.S. dollar repos, European credit default swaps, foreign exchange options, interest rate derivatives and U.S. TIPS. As BGC and other voice-brokers commoditize more of their previously less liquid marketplaces and brokers of such products become aware of the benefits of electronically-assisted trading for such products, through our technology, we expect these factors will lead to a migration towards more fully electronic trading volume.

### **Develop futures routing and ECCO software business**

Our futures business comprises an order routing service that offers customers access to the futures markets over the eSpeed network and the ECCO front-end trading software product that provides sophisticated trading tools such as automated spreading. We plan to grow these complementary businesses by leveraging the current eSpeed customer base to expand the ECCO business while at the same time connecting new and existing ECCO customers to our eSpeed futures order routing service. More generally, we continue to market our routing services through the alternative eSpeed front-end and via API access while independently targeting our ECCO software products at the wider professional electronic futures trading community.

### **Customized pricing alternatives for our foundation businesses**

We plan to improve upon our position as a pioneer and innovator in electronic trading of U.S. Treasury securities through improvements to our platform and product offerings for current and future customers. In 2006, we continued to negotiate new pricing arrangements with many of our largest customers for U.S. Treasury products that provide a greater share of fixed payments versus variable commissions, thus creating incentives for more trading volume. Certain of our other largest customers continue to pay transaction fees based on trading volume although we believe that as U.S. Treasury volumes increase over time, customers with variable price agreements will qualify for volume discounts and fixed price arrangements. Our goal is to maximize trading volumes and related revenues as we respond to customer demands on our platform.

### **License our software to a broad range of market participants and provide an outsourced eSpeed Software Solution for distribution of their products**

Through Software Solutions, we plan to continue to capitalize on our global infrastructure, intellectual property and electronic trading expertise to provide a complete outsourced solution to our customers to enable them to access exchanges and electronic markets and distribute their branded products to their customers through online offerings, auctions, including private and reverse auctions, direct dealing capabilities and customized trading interfaces. Our sales force is focused on licensing our eSpeed Software Solutions technology to existing and new customers worldwide.

### **Leverage our intellectual property portfolio**

We have a strong intellectual property portfolio and are committed to developing, maintaining and protecting our existing portfolio and developing and protecting new enhancements, products and inventions. We have historically entered into long-term licensing agreements with respect to our intellectual property with a number of customers and exchanges and, from time to time, are engaged in legal action to protect or defend our intellectual property. See Item 3. Legal Proceedings. We plan to continue our strategy of developing, maintaining and protecting these existing and new technologies. Our strategy may also include licensing such intellectual property for royalties, joint venturing with other marketplaces or exchanges or exclusively using patents in our marketplaces.

### **Expand electronic foreign exchange marketplace**

Our foreign exchange product is an anonymous, neutral, real-time, instantaneous electronic trading system. We plan to leverage our technology and customer arrangements to add increased liquidity and trading customers to this marketplace. In 2004 and 2005, we hired an experienced sales team and reorganized our foreign exchange initiatives and in 2006, we added an industry veteran as global head of electronic foreign exchange. We continue to invest in our foreign exchange platform.



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### **Capitalize on expected market growth from computer-based proprietary trading by expanding trading and products in this marketplace**

Many of our customers and other firms have added computer-based automated trading, using statistical arbitrage and algorithmic methods, to their operations to manage portfolios and automatically execute trades. We plan to further develop software and other products and services to add new methods to continue to improve system performance and capacity and drive efficiency for algorithmic solutions. We have positioned our technology and service of our eSpeed platform to provide products and services that will capitalize on this market change and growth.

### **Pursue strategic alliances, acquisitions and other partnering opportunities**

We are continually exploring opportunities to maximize stockholder value by expanding our fully electronic, integrated hybrid voice-assisted and other markets, enhancing our other partnering opportunities, product and service offerings, and generating future growth and market position, including through any one or more strategic alliances, acquisitions or combinations, strategic alliances, customer agreements, joint ventures, equity issuances and reorganizations and recapitalizations in our core business as well as in strategic or complimentary businesses. From time to time, we seek to enter into acquisitions, partnership arrangements, joint ventures, customer agreements and other strategic alliances to create liquidity in new and existing product markets, to develop and enhance technology offerings and services, to fully utilize our patents and to attract new participants to trade products in those markets. We have employed this strategy in our alliance with Freedom, Aqua and in our other ventures, as well as in our acquisition of ECCO and our relationships with Cantor and BGC, and will consider additional strategic opportunities with these and other potential partners in the coming periods.

### **Emphasize fundamental principles through dedication to customer service**

We have recognized that our foundation and growth business objectives cannot be achieved without continuous focus on our fundamental principles of speed, simplicity and service. To put these principles into practice, we continue to explore opportunities and dedicate resources to strong customer service. We have hired an experienced sales team and are dedicated to providing timely and effective service to customers, responding to and anticipating customer needs and requests and making our platform more user-friendly. We plan to continue to dedicate our time and effort to these principles.

## **TECHNOLOGY**

Our eSpeed system is accessible to our customers through (i) our proprietary front-end trading software, (ii) our application programming interface ( API ), which is a dedicated software library linking our customers' networks to our system, (iii) the Internet, via a browser interface or Java application, and (iv) software developed in alliances with independent software vendors. Our system runs on large-scale hardware located in data centers in the U.S. and the U.K. and is distributed either over our multiple-path global network or via the Internet through links to multiple global Internet service providers.

Our electronic marketplaces operate on a technology platform and network that emphasize scalability, performance, adaptability and reliability. Our technology platform consists of:

- our proprietary, internally developed real-time global network distribution system;

- our proprietary transaction processing software, which includes interactive matching auction engines, fully integrated credit and risk management systems, pricing engines, analytics and associated middle- and back-office operations systems; and

- customized inventory distribution and auction protocols designed to be used by our customers and partners in their distribution and trading systems and customer interfaces ranging from Windows, Java, UNIX, LINUX, our proprietary API and proprietary vendor access.

Together, these components enable our customers to effect transactions in real-time, with straight-through processing.

*Network distribution system*

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Our eSpeed system contains a proprietary hub-and-spoke digital network. This network uses Cisco Systems' network architecture, and we have Cisco-certified engineers on-site. Our network's high-speed points of presence comprise the major business centers of the world, including New York, London, Tokyo, Hong Kong, Singapore, Milan, Chicago, Los Angeles and Toronto. Altogether, we manage 35 hubs linked by over 50,000 miles of cable, over 1,000 Cisco network devices and more than 2,000 high-capacity Sun Microsystems and Hewlett Packard servers located in data centers in London, Chicago, New York and New Jersey that are able to process over 600 transactions per second, per auction instrument or product. The redundant structure of our

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system provides multiple backup paths and re-routing of data transmission if one spoke of a hub fails. We believe that we operate one of the largest and most robust interactive trading network distribution systems currently in operation, with the substantial majority of our personnel dedicated to our trading technology and committed to developing new products and services.

Our trading system accepts orders and postings and distributes responses, generally in under 100 milliseconds. We estimate that our network is currently running at approximately 15% to 20% of capacity over a 24-hour period.

In addition to our own network system, we also receive and distribute secure trading information from customers using the services of multiple, major Internet service providers throughout the world. These connections enable us to offer our products and services via the Internet to our global customers.

### *Transaction processing software*

Our software applications have been developed internally and are central to the success of our eSpeed system. Our auction and trading engines operate in real-time, facilitating efficient interaction between buyers and sellers. Our credit and risk management systems monitor and regulate these buyers and sellers. Our pricing engines provide prices for illiquid financial products derived from multiple trades in other related financial instruments and our TOPS engine enhances our voice-based market pipeline by handling hundreds of spread and basis orders in each marketplace to facilitate liquidity in otherwise more barren areas. These critical applications work together seamlessly and are supported by middle- and back-office software that verifies, confirms, reports, stores, tracks and, if applicable, enables the settlement of each transaction. Our transaction processing software includes verification mechanisms at various stages of the execution process, which result in significantly reduced manual intervention, decreased probability of erroneous trades and more accurate execution for customers.

### *eSpeed auction and transaction engines*

Our auction and transaction engines use Interactive Matching, our proprietary rules-based method, instrument or product. These engines were developed to support trading in the largest capital markets in the world, such as government bonds and futures contracts, and the more diverse, fragmented and database intensive markets, such as U.S. municipal bonds (with over 1.7 million different issues), corporate bonds and Eurobonds. These transaction engines are designed to be modular and flexible to allow modification in order to apply them to other markets and auction types. In Europe, for example, we have added a component that allows us to process transactions and auctions in multiple currencies simultaneously. Our transaction engines have embedded security features and an added messaging layer, via our proprietary API, to provide security from unauthorized use. In addition, we use encryption to protect our customers that transact business over the Internet.

We believe our marketplace expertise and rules-based systems provide incentives for customers to actively participate in our marketplaces. For example, Interactive Matching provides incentives to participate in our marketplaces by encouraging participants to expose their orders to the market. In standard auctions, the incentive is for participants to wait until the last moment to make a bid or offer. Our priority rules encourage trading activity by giving the last successful active participant a time-based right of first refusal on the next sale or purchase. In addition, in many markets, we have structured our pricing policy to provide incentives. The party that provides auction products for the market or creates liquidity (by inputting a price to buy or sell) generally pays less commission than the participant that consummates the trade by acting on that price. With our pricing policies and proprietary priority rules, our system is designed to increase liquidity and to draw participants into the market. This proprietary rules-based system is adaptable and, as part of our business strategy, we intend to apply it across other non-financial markets for multiple products and services.

### *eSpeed Credit Master<sup>SM</sup> credit and risk management systems*

Our eSpeed Credit Master credit and risk management systems are an important part of the operation of our electronic marketplaces. These systems (i) continuously monitor trades of our customers to help prevent them from exceeding their credit limits, (ii) automatically prevent increased exposure from further trading once a customer has reached a pre-determined credit limit and (iii) evaluate transactions and calculate both individual positions and risk exposure across various products and credit limits.

### *eSpeed Name Give-Up Matrix<sup>SM</sup> credit monitoring*

Through the use of our name give-up matrix, we enable our market participants to create counterparty credit exposure limits to manage the counterparties with which they transact in non-central counterparty markets. In these markets, participants settle transactions directly with other participants. Using this matrix module, the participants can pre-select the counterparties that they are willing to transact with in that market. The module displays all prices to market participants, and highlights and enables execution on prices that are from approved counterparties. Additionally, the module has features that permit each participant to manage the activities of its traders on a real-time basis.





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### *eSpeed pricing engines and analytics*

We have developed a number of analytical software tools that permit us to price products that trade in less liquid markets and for which current pricing information is not readily available. For example, our TOPS system is a proprietary computer application that enables us to link multiple markets, offer prices and create and enhance marketplaces for products that have limited liquidity. In our financial markets, TOPS currently uses data from existing cash and futures markets to calculate pricing for transactions where no market prices currently exist, thereby facilitating liquidity. These multi-variable trades are extremely difficult to execute in voice-based markets due to their complexity and the slow speed of manual execution.

### *eSpeed middle- and back-office applications*

Our middle- and back-office applications support clearance, settlement, tracking and reporting of trades and provide links to outside clearing entities. For example, in the financial markets, we outsource our clearance and settlement services to Cantor and Freedom (for Canadian markets), where both parties to a trade send either cash or securities to Cantor or Freedom and Cantor or Freedom settles the trade and sends each party the cash or securities due. Our reporting and accounting systems are designed to track and record all charges and commissions for a trade. Our eSpeed system and products automate previously paper- and telephone-based transaction processing, confirmation and other functions, substantially improving and reducing the cost of many of our customers' back offices and enabling straight-through processing.

## **OUR CUSTOMERS**

Our customers include banks, dealers, brokers, professional trading firms, futures commission merchants and other professional market participants and other financial institutions. We are a trusted source for electronic trading at the world's largest fixed income and foreign exchange trading firms and major exchanges. Other than Cantor and BGC, no customer of ours accounts for more than 10% of our revenues.

We provide access to the electronic marketplaces and broker-assisted services supported by our eSpeed system. We expect that a portion of our customers who use voice brokers will migrate to fully electronic access over the coming years or will use our integrated hybrid voice-assisted products and brokerage services. We intend to continue to license our intellectual property. We also expect to add customers for eSpeed Software Solutions from the financial markets. In addition, we intend to build relationships with new customers, including traditional competitors of Cantor and BGC. We further intend to provide third parties with the infrastructure, including systems administration, internal network support and operations and disaster recovery services, that is critical to providing fully electronic marketplaces in a wide variety of products.

## **PRICING POLICIES**

Pursuant to certain transaction fee agreements with certain of our customers, including many of our largest customers, such customers receive brokerage services for the electronic arrangement and execution of financial transactions for a variety of fixed income securities at fees below our standard prevailing fees. These agreements typically provide for payment by each customer of a fixed periodic payment and/or product-specific transaction fees based on the aggregate notional value of securities bought or sold by the customer plus, where applicable, exchange fees and costs. The initial terms of these agreements typically last between one and three years, with provision for automatic renewal unless elected otherwise by either party.

In the third quarter of 2004, we announced a strategic shift in our pricing strategy for our U.S. Treasury business that increased the component of fixed pricing and reduced the percentage of variable pricing in contracts with certain of our largest customers. During the second half of 2004 and throughout 2005 and 2006, we have worked with these customers to create customized pricing arrangements that lower their marginal cost of trading on the eSpeed platform, and encourage greater market participation. In January 2005, we removed the Price Improvement feature from our trading platform in response to requests of customers, thereby reducing the effective variable cost of transaction on our eSpeed network. We believe that this has resulted, and will continue to result, in more predictable market volumes on the eSpeed platform. In addition, in anticipation of projected increases in U.S. Treasury volumes, we believe that more customers with variable pricing in contracts will qualify for such volume for discounts and fixed price arrangements in the future.

## **SALES, MARKETING AND CORPORATE DEVELOPMENT**

We promote our electronic marketplaces and services to our existing and prospective customers through a combination of sales, marketing and co-marketing campaigns. We leverage our customer relationships through a variety of direct marketing and sales initiatives and build and enhance our brand image through marketing and communications campaigns targeted at a diverse audience, including traders, potential partners and the investor and press communities. We also may market to our existing and prospective customers through a variety of

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co-marketing/co-branding initiatives with our partners. We have designed our sales and marketing efforts to promote brand awareness and educate our audience regarding the nature of our electronic marketplaces, products and services and the advantages associated with the automation of trading activities.

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Our senior management staff actively works to establish strategic relationships, develop new markets for our technology and structure and execute investments and acquisitions. Our staff promotes eSpeed at conferences, conventions, events and speaking engagements that advance both our technology and our brand name. In many cases, these engagements are focused within specific markets that we intend to develop in the future. All of these efforts are intended to enhance our image, customer awareness and profitability.

### **SOFTWARE DEVELOPMENT**

We devote substantial efforts to the development and improvement of our electronic marketplaces and licensed software products and services. We work with our customers to identify their specific requirements and make modifications to our software, network distribution systems and technologies that are responsive to those needs. Our efforts focus on internal development, strategic partnering, acquisitions and licensing. As of December 31, 2006, we employed 352 technology professionals.

One of our technology team's main objectives is to develop new products and services in order to provide superior electronic marketplace solutions to our customers. We also focus our efforts on enhancing our Internet interfaces to facilitate real-time markets and comply with standard Internet security and future security protocols in order to capitalize on the development of new commercial marketplaces. We are continuing to develop new marketplaces and products and services using our internally developed application software.

### **COMPETITION**

The development and operation of electronic marketplaces are evolving. Because our business is driven by a number of different products, we face different levels of competition with respect to each market and product. As a result, competition in these marketplaces is currently fragmented. We face competition from a number of different sources varying in size, business objectives and strategy, some of which are larger than we are and have greater financial resources.

Although we do not believe that there is another fully integrated, multi-asset platform offering electronic trading across futures, foreign exchange and fixed income, there are a number of competitors in each of those markets. Our current and prospective competitors are numerous and include interdealer brokerage firms, multi-dealer trading companies, technology companies and market data and information vendors, securities and futures exchanges, electronic communications networks, crossing systems, software companies, consortia, business-to-business marketplace infrastructure companies and niche market energy and other commodity Internet-based trading systems. ICAP Plc, an interdealer broker in the financial markets, is a significant competitor for us in electronic trading of government securities and is a significant competitor in the electronic spot foreign exchange markets, along with Reuters. There are also a number of smaller electronic trading platforms competing in the foreign exchange space. For example, Knight Capital Group, Inc., a trade execution specialist, announced in January 2006 that it has agreed to acquire Hotspot FX, Inc., a firm that provides institutions and dealers with spot foreign exchange trade execution through a fully electronic platform. The futures market also has a number of different order-routing and Independent Software Vendor ( ISV ) solutions for electronic trading, including Trading Technologies International, Inc., Patsystems plc, RTS Systems AG, Marex Financial Ltd, FFastFill plc and other providers. GFI Group, Inc., Creditex Inc. and ICAP Plc are currently active in the credit derivatives market area in which we and our affiliate BGC compete, and many of these competing firms have fully-electronic credit derivatives products. We believe that we may also face future competition from large computer software companies, market data and technology companies and some securities brokerage firms, some of whom are currently our customers, as well as from any future strategic alliances, joint ventures, or other partnerships created by one of more of our potential or existing competitors.

The electronic marketplace solutions we provide to our customers enable them to expand the range of services they provide to their ultimate customers to trade across multiple marketplaces. We believe our electronic marketplaces compete primarily on the basis of speed, functionality, efficiency, price, system stability and ability to provide market participants with access to liquidity. We also believe that the time and expense required to develop technology and create electronic marketplaces will serve as significant barriers to entry for our competitors.

### **PROTECTION OF OUR INTELLECTUAL PROPERTY**

We have adopted a comprehensive intellectual property program to protect our proprietary technology. We currently have licenses covering various Cantor patents in the U.S., including patents relating to (i) a system and method for auction-based trading of specialized items such as fixed income instruments, (ii) a fixed income portfolio index processor, and (iii) a system for shared remote access of multiple application programs by one or more computers. Foreign counterpart applications for some of these U.S. patents have been filed. The licenses are exclusive, except in the event that we do not seek to or are unable to provide to Cantor any requested services covered by the patents and Cantor elects not to require us to do so.



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We also have an agreement to license several pending U.S. patent applications relating to various other aspects of our electronic trading systems, including both functional and design aspects. We have filed a number of patent applications to further protect our proprietary technology and innovations, and have received patents that have issued from some of those applications.

In April 2001, we purchased the Wagner Patent, which addresses automated futures trading and provides for bids and offers to be placed and matched electronically. In August 2002, we and Electronic Trading Systems Corporation ( ETS ), the former owner of the Wagner Patent, entered into a Settlement Agreement with CME and CBOT to resolve litigation with CME and CBOT related to the Wagner Patent and provide for certain licenses. The Wagner Patent, which expired in February 2007, involved automated futures trading systems in which transactions are completed by computerized matching of bids and offers of futures contracts on an electronic platform. On March 29, 2002, we entered into a long-term licensing agreement with ICE, granting use of our Wagner Patent to ICE, which expired on February 20, 2007. In December 2002, we entered into an agreement with CBOT to distribute futures products over our eSpeed system. In December 2003, we entered into a Settlement Agreement containing a license agreement with NYMEX to resolve litigation with NYMEX related to the Wagner Patent. With respect to all of these agreements, a portion of the fees received by eSpeed was paid to ETS.

In July 2004, we entered into an agreement with NYBOT, expiring in 2017, which provided among other things for payments in respect of NYBOT's electronic futures trading through 2017. As a result of the NYBOT Agreement, we are the sole owner of the Cantor Financial Futures Exchange and the Commodity Futures Clearing Corporation of New York. Additionally, we have agreed with NYBOT that NYBOT will provide processing services for futures contracts or options on futures contracts listed on the Cantor Financial Futures Exchange or other exchange designated by us.

Our patent portfolio is growing and consists of numerous patents and patent applications relating to our core business and relating to other businesses. We continue to look for opportunities to license and/or otherwise monetize these and other patents in our portfolio. Some of our patents are the subject of litigation. See Item 3. Legal Proceedings.

We cannot at this time determine the significance of any of the foregoing patents, or future patents, if issued, to our business. We can give no assurance that any of the foregoing patents will be found by a court to be valid and enforceable, or that any of these patents would not be infringed by a third party competing or seeking to compete with our business. Our business strategy may include licensing such patents for royalties, joint venturing with other marketplaces or exchanges, or exclusively using the patents in our marketplaces and other product and service offerings.

## **SEGMENT AND GEOGRAPHIC INFORMATION**

See Item 8. Financial Statements and Supplemental Data Note 18 for more information regarding segment and geographic information.

## **EMPLOYEES**

As of December 31, 2006, we had 400 employees, five of whom are our executive officers. None of these employees is represented by a union. We believe that we have good relations with our employees.

## **WEBSITE ACCESS TO REPORTS AND AVAILABLE INFORMATION**

Our Internet website address is [www.espeed.com](http://www.espeed.com). Through our Internet website, we make available the following reports as soon as reasonably practicable after electronically filing them with, or furnishing them to, the SEC: our annual report on Form 10-K; our quarterly reports on Form 10-Q; our current reports on Form 8-K; and amendments to those reports. Our Internet website also contains copies of our Code of Business Conduct and Ethics, Audit Committee Charter and Complaint and Investigation Procedures for Accounting, Internal Accounting Controls, or Auditing Matters. Our Proxy Statements for our Annual Meetings are also available through our Internet website. Our Internet website and the information contained therein or connected thereto are not intended to be incorporated into this Report.

## **ITEM 1A. RISK FACTORS**

In addition to the other information in this Report, the following risk factors should be considered carefully in evaluating us and our business:



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**RISKS RELATED TO OUR BUSINESS**

**Our revenues and profitability may be adversely affected by changes in the U.S. Treasury markets and a reduction in our market position in the U.S. Treasury markets.**

Our business is highly dependent upon the volume of bonds being traded through our eSpeed system. We believe that we have historically been a leader in the U.S. Treasury benchmark market, and our revenues are concentrated in this business. Because our business is highly concentrated in the government bond markets of the world, particularly U.S. Treasuries, our business, revenues and profitability could be adversely impacted by various factors, including U.S. Treasury market position declines and interest rate volatility, as well as competition within the marketplace. During 2004 and the beginning of 2005, our market position in the U.S. Treasury market declined, resulting in a material adverse impact on our revenues and profitability. Although our position in the U.S. Treasury market has improved, market position declines from current levels would adversely affect our business revenues and profitability.

**If we do not expand the use of our electronic systems, or if our customers do not use our marketplaces or services, our revenues and profitability could be adversely affected.**

The success of our business plan depends, in part, on our ability to maintain and expand the network of trading firms, dealers, banks and other financial institutions that use our interactive electronic marketplaces. This is particularly important in the early years of a new marketplace where we attempt to attract a critical mass of participants or in a mature marketplace where certain revenues are concentrated from key customers. We cannot assure you that we will be able to continue to expand our marketplaces, or that we will be able to retain the current participants in our marketplaces. Although some of our agreements with market participants require certain minimum payments, none of our agreements with market participants require them to use our electronic marketplaces and from time to time, we may experience departures of key customers or reduction in volumes from such customers which may adversely affect our revenues. Additionally, we currently expect to enter into strategic alliances with other market participants, such as retail brokers, exchanges, market makers, consortia, clearinghouses, major market participants and technology companies, in order to increase customer access to and use of our electronic marketplaces. We cannot assure you that we will be able to continue to enter into these strategic alliances on terms that are favorable to us, or at all. In addition, we cannot assure you that our current or future strategic alliances will be successful.

**If we experience declining trading volume in products or if we are unable to capture demand for new products, our revenues and profitability could suffer.**

From time to time, we have experienced significant fluctuations in the aggregate trading volume of products being traded in our marketplaces. We believe that fluctuations in the trading volume of products traded in our marketplaces could occur in the future from time to time and in such event, could have a direct impact on our future operating results. This could cause significant fluctuations in our revenues and profitability when the trading volumes are low. In addition, from time to time, Cantor, BGC and their affiliates participate in certain of our marketplaces by posting quotations for their accounts and by acting as principal on trades. Although these activities are intended, among other things, to assist these affiliates in managing their proprietary positions, and to facilitate transactions, add liquidity, increase commissions and attract additional order flow to the eSpeed system and revenue to both us and Cantor, BGC and their affiliates, we may nevertheless experience significant fluctuations in our trading volumes, revenues and profitability. In addition, we may experience difficulty in creating demand for new fully-electronic products or in attracting customers or market makers on a large scale with respect to certain new products. Failure to capture customers for such products may have an adverse impact on our revenues or profitability.

**Our revenues and profitability could be limited or otherwise adversely affected by pricing plans relating to commissions and fees on our trading platform.**

We negotiate from time to time with certain of our customers (including many of our largest customers) to enter into customized pricing plans. In many of these pricing plans, the aggregate amount of transaction fees payable by a customer for certain products is capped on a monthly, quarterly or other basis. While the fee cap is designed to encourage our customers to be more active on our electronic trading platform, the fee cap limits the maximum amount of commissions payable to us by certain of our most active customers, which could limit our revenues and constrain our profitability. Since 2004, our fully electronic revenue has declined as a percentage of total revenue due in part to these competitive pricing pressures and there can be no assurance that these revenues will remain at current levels.



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**Our growth with respect to computer-based trading customers may fluctuate from time to time.**

With the introduction of computer-based, algorithmic or program trading we have seen significant growth in our marketplace both with respect to liquidity and execution volumes. This additional liquidity attracts new entrants to our marketplace. Many of our new customers are focused on program trading solutions and will likely contribute to the liquidity growth and overall efficiency of the marketplace. These new participants are extremely sensitive to latencies and require technology advances to maintain response time and quality service. Should we not be able to maintain a suitable performance level, our growth in computer-based trading could suffer significantly.

**If we are unable to enter into additional marketing and strategic alliances or our current or future strategic alliances are not successful, we may not generate increased trading in our integrated hybrid voice-assisted and our fully electronic marketplaces.**

We expect to continue to enter into strategic alliances with other market participants, such as retail brokers, exchanges, market makers, consortia, clearinghouses, major market participants and technology companies, in order to increase customer access to and use of our electronic marketplaces. We cannot assure you that we will be able to continue to enter into these strategic alliances on terms that are favorable to us, or at all. In addition, we cannot assure you that our current or future strategic alliances will be successful. The success of our current and future relationships will depend on the amount of increased trading in our integrated hybrid voice-assisted and our fully electronic marketplaces and the liquidity generated therein. These arrangements may not generate the expected number of new customers or increased trading volume we are seeking.

**If Cantor or we are unable to protect the intellectual property rights we own or license from Cantor, our ability to operate electronic marketplaces may be materially adversely affected.**

Our business is highly dependent on proprietary technology and other intellectual property rights. We license some of our patented technology from Cantor. The license arrangement is exclusive, except in the event that (i) we are unwilling to provide to Cantor any requested services covered by the patents with respect to a marketplace and Cantor elects not to require us to do so, or we are unable to provide such services or (ii) we do not exercise our right of first refusal to provide to Cantor or its affiliates electronic brokerage services with respect to a marketplace, in which case Cantor retains a limited right to use the patents and patent applications solely in connection with the operation of that marketplace. We cannot guarantee that the concepts which are the subject of the patents and patent applications covered by the license from Cantor or that we own are patentable or that issued patents are or will be valid and enforceable or that such concepts will be marketable or profitable for our business. Where patents are granted in the U.S., we can give no assurance that equivalent patents will be granted in Europe or elsewhere, as a result of differences in local laws affecting patentability and validity. Moreover, we cannot guarantee that Cantor's issued patents or our issued patents are valid and enforceable, or that third parties competing or intending to compete with us will not infringe any of these patents. Despite precautions we or Cantor has taken or may take to protect our intellectual property rights, it is possible that third parties may copy or otherwise obtain and use our proprietary technology without authorization. It is also possible that third parties may independently develop technologies similar to ours. It may be difficult for us to monitor unauthorized use of our proprietary technology and intellectual property rights. We cannot assure you that the steps we have taken will prevent misappropriation of our technology or intellectual property rights.

**We have had to resort to costly litigation to protect and defend certain of our intellectual property rights; some rulings to date have not been in our favor.**

We are currently involved in costly litigation to protect and defend certain of our intellectual property rights and may be subject to such litigation in the future. Some rulings to date have not been in our favor. See Item 3. Legal Proceedings. We may have to continue to resort to litigation to protect our intellectual property, determine the validity and scope of the proprietary rights of others or defend ourselves from claims of invalidity or unenforceability. We may incur substantial costs and diversion of resources as a result of litigation, even if we win. In the event we do not win, we may have to pay the attorneys' fees and costs of the other party. We may also have to expend resources to modify existing products or lose opportunities to generate potential future revenues or create future barriers to entry. The outcome of these cases may result in an adverse financial impact on our business, including a charge to earnings as a result of impairment of our intellectual property or payments, required by any adverse decision or loss of intellectual property rights. Such results may be unpredictable and may from time to time have a material impact on our financial conditions, results of operations or cash flows in a given period.

**If we infringe on the intellectual property of others, we could become involved in costly litigation and suffer adverse results.**

Intellectual property rights of third parties may have an important bearing on our ability to offer certain of our products and services. We cannot assure you that we are or will be aware of all patents or copyrights containing claims that may pose a risk of infringement by our products and services. We are currently defending a patent infringement claim. See Item 3. Legal



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Proceedings. In addition, patent applications in the U.S. are generally confidential for a period of time, which can last until a patent is issued. As a result, we cannot evaluate the extent to which our products and services may be covered or asserted to be covered by claims contained in pending patent applications. In general, if one or more of our products or services were to infringe patents held by others, we may be required to stop developing or marketing the products or services, to pay damages, to obtain licenses to develop and market the products and services from the holders of the patents or to redesign the products or services in such a way as to avoid infringing on the patent claims, which could limit the manner in which we conduct our operations, adversely affect our market position, lead to increased competition in the marketplaces in which we provide our products and services and otherwise have a material impact on our financial condition, results of operations or cash flows in a given period. Defense and litigation of third-party infringement claims against us, with or without merit, have been and may continue to be costly to us.

### **If our software licenses from third parties are terminated, our ability to operate our business may be materially adversely affected.**

We license database and other software from third parties, much of which is integral to our systems and our business. The licenses are terminable if we breach our obligations under the license agreements. If any of these relationships were terminated or if any of these third parties were to cease doing business, we may be forced to spend significant time and money to replace the licensed software. However, we cannot assure you that the necessary replacements will be available on reasonable terms, if at all.

### **We may experience technology failures while developing and enhancing our software.**

In order to maintain our competitive advantage, our software is under continuous development. There is risk that software failures may occur and result in service interruptions and have other unintended consequences, which could have a material adverse effect on our business, financial condition and results of operation.

### **If the strength of our brand names is diluted, the value of our proprietary rights may decrease.**

We own many Internet domain names, including *www.espeed.com*. The regulation of domain names in the U.S. and in foreign countries may change and the strength of our brand names could be diluted. We may not be able to prevent third parties from acquiring domain names that infringe or otherwise decrease the value of our trademarks and other proprietary rights.

We use our eSpeed registered trademark and service mark for the products and services described herein and have registered that trademark and service mark in a number of jurisdictions around the world. We are not presently aware of any third-party objections to our use or registration of our eSpeed registered trademark or service mark in any countries, or of any third-party trademark or service marks that are likely to pose an impediment to our use or registration of our eSpeed registered trademark or service mark in any countries. Nevertheless, there is always a possibility that an objection by a third-party trademark or service mark owner could potentially affect the registration, and/or limit our use, of our eSpeed registered trademark or service mark in one or more countries, thereby requiring us to adopt and use another trademark or service mark for our products and services in such country or countries.

### **Due to intense competition, our market position and financial performance have suffered in the past and could be subject to decline in the future.**

The electronic trading and Internet-based financial services markets are highly competitive, and many of our competitors are more established and have greater financial resources than us. Many of our competitors also have greater market presence, financial, engineering and marketing capabilities and technological and personnel resources than we do. As a result of this intense competition, our market position and financial performance have suffered in the past and could be subject to decline in the future to suffer as a result of competitive pressures. We expect that competition will intensify in the future. In particular, our market position and financial performance may suffer if our competitors:

develop and expand their network infrastructures and service offerings more efficiently or more quickly;

adapt more swiftly to new or emerging technologies and changes in customer requirements;

take advantage of acquisitions and other opportunities more effectively;

devote greater resources to the marketing and sale of their products and services;

aggressively reduce their pricing to enter into or expand their market share to build customer relationships in market segments in which we have significant market share today; and

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leverage relationships with customers and strategic partners more effectively or exploit more recognized brand names to market and sell their services.

Our current and prospective competitors are numerous and include interdealer brokerage firms, multi-dealer trading companies, technology companies and market data and information vendors, securities and futures exchanges, electronic communications networks, crossing systems, software companies, consortia, business-to-business marketplace infrastructure companies and niche market energy and other commodity business-to-business Internet-based trading systems. ICAP, an interdealer broker in the financial markets, is a significant competitor for us in electronic trading of government securities and is a significant competitor in the electronic spot foreign exchange markets, along with Reuters. There are also a number of smaller electronic trading platforms competing in the foreign exchange space. For example, Knight Capital Group, Inc., a trade execution specialist, announced in January 2006 that it has agreed to acquire Hotspot FX, Inc., a firm that provides institutions and dealers with spot foreign exchange trade execution through a fully electronic platform. The futures market also has a number of different order-routing and ISV solutions for electronic trading, including Trading Technologies, Patsystems plc, RTS Systems AG, Marex Financial Ltd, FFastFill plc and other providers. GFI Group, Inc., Creditex Inc. and ICAP Plc are currently active in the credit derivatives market area in which we and our affiliate BGC compete, and many of these competing firms have fully-electronic credit derivatives products. We believe that we may also face future competition from large computer software companies, market data and technology companies and some securities brokerage firms, some of whom are currently our customers, as well as from any future strategic alliances, joint ventures, or other partnerships created by one of more of our potential or existing competitors.

The number of businesses providing Internet-based financial and non-financial services is rapidly growing, and other companies, in addition to those named above, have entered into or are forming joint ventures or consortia to provide services similar to those provided by us. Others may acquire the capabilities necessary to compete with us through acquisitions.

### **If we experience computer systems failures or capacity constraints, our ability to conduct our operations could be harmed.**

We internally support and maintain many of our computer systems and networks. Our failure to monitor or maintain these systems and networks or, if necessary, to find a replacement for this technology in a timely and cost-effective manner would have a material adverse effect on our ability to conduct our operations. Our data centers could be subject to failure due to environmental factors, power outage and other factors. Accordingly, we may be subject to system failures and outages which might impact our revenues and relationship with customers. In addition, we are subject to risk in the event that systems of our partners, customers, customers or vendors, including Cantor and BGC, are subject to failures and outages.

We also rely and expect to rely on third parties for various computer and communications systems, such as telephone companies, online service providers, data processors, clearance organizations and software and hardware vendors. Our systems, or those of our third-party providers, may fail or operate slowly, causing one or more of the following:

unanticipated disruptions in service to our customers;

slower response times;

delays in our customers' trade execution;

failed settlement of trades;

incomplete or inaccurate accounting, recording or processing of trades;

financial losses;

litigation or other customer claims; and

regulatory sanctions.

We experienced systems and telecommunications failures in connection with the September 11 Events. We cannot assure you that we will not experience additional systems failures in the future from power or telecommunications failure, acts of God or war, terrorist attacks, human error, natural disasters, fire, power loss, sabotage, hardware or software malfunctions or defects, computer viruses, intentional acts of vandalism and similar events. Any system failure that causes an interruption in service or decreases the responsiveness of our service, including failures caused by customer error or misuse of our systems, could damage our reputation, business and brand name.

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### **We may incur losses in the future.**

While we were profitable in 2006, as we continue to develop our systems and infrastructure and expand our brand recognition and customer base through increased hiring of sales and other personnel, we may incur losses in the future.

### **The financial markets in which we operate are generally affected by seasonality.**

Traditionally, the financial markets around the world experience lower volume during the summer and at the end of the year due to a general slowdown in the business environment and, therefore, our transaction volume levels may decrease during those periods. The timing of the holidays also affects transaction volume. These factors could have a material adverse impact on our financial performance in a given period.

### **We operate in a rapidly evolving business environment. If we are unable to adapt our business effectively to keep pace with these changes, our ability to succeed will be adversely affected.**

The pace of change in our market is extremely rapid. Operating in such a rapidly changing business environment involves a high degree of risk. Our ability to succeed will depend on our ability to adapt effectively to these changing market conditions. If we are unable to keep up with rapid technological changes, we may not be able to compete effectively.

To remain competitive, we must continue to enhance and improve the responsiveness, functionality, accessibility and features of our proprietary software, network distribution systems and technologies. Our business environment is characterized by rapid technological changes, changes in use and customer requirements and preferences, frequent product and service introductions embodying new technologies and the emergence of new industry standards and practices that could render our existing proprietary technology and systems obsolete.

### **If we are unable to keep up with rapid technological changes, we may not be able to compete effectively.**

To remain competitive, we must continue to enhance and improve the responsiveness, functionality, accessibility and features of our proprietary software, network distribution systems and technologies. Our business environment is characterized by rapid technological changes, changes in use and customer requirements and preferences, frequent product and service introductions embodying new technologies and the emergence of new industry standards and practices that could render our existing proprietary technology and systems obsolete. Our success will depend, in part, on our ability to:

develop, license and defend intellectual property useful in our business;

enhance our existing services;

develop new services and technologies that address the increasingly sophisticated and varied needs of our existing and prospective customers; and

respond to technological advances and emerging industry standards and practices on a cost-effective and timely basis.

We cannot assure you that we will be able to respond in a timely manner to changing market conditions or customer requirements. The development of proprietary electronic trading technology entails significant technical, financial and business risks. Further, the adoption of new Internet, networking or telecommunications technologies may require us to devote substantial resources to modify, adapt and defend our technology. We cannot assure you that we will successfully implement new technologies or adapt our proprietary technology and transaction-processing systems to customer requirements or emerging industry standard, or that we will be able to successfully defend any challenges to any technology we develop.

### **Our networks and those of our third-party service providers may be vulnerable to security risks, which could make our customers hesitant to use our electronic marketplaces.**

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We expect the secure transmission of confidential information over public networks to be a critical element of our operations. Our networks and those of our third-party service vendors, including Cantor and BGC and associated clearing corporations, and our customers may be vulnerable to unauthorized access, computer viruses and other security problems. Persons who circumvent security measures could wrongfully use our information or cause interruptions or malfunctions in our operations, which could make our customers hesitant to use our electronic marketplaces. We may be required to expend significant resources to protect against the threat of security breaches or to alleviate problems, including reputational harm and litigation, caused by any breaches. Although we intend to continue to implement industry-standard security measures, we cannot assure you that those measures will be sufficient.



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**If we fail to maintain an effective internal control environment, our business and stock price could suffer.**

The Sarbanes-Oxley Act of 2002 and the related SEC rules require our management to conduct annual assessments of the effectiveness of our internal control over financial reporting and a report by our independent registered public accounting firm addressing our internal control over financial reporting. We have just completed a restatement of our financial statements with respect to certain revenues and expenses related to a portion of the development of related party software, and in connection with that restatement, concluded that our internal control over financial reporting was not effective at December 31, 2006. In addition, our independent registered public accounting firm has issued a revised report concluding that our internal control over financial reporting was not effective at December 31, 2006. While we have taken various remedial steps to improve our internal control over financial reporting, management has not conducted an assessment of our internal control over financial reporting since we took those steps; nor have we requested or received from our independent registered public accounting firm a new report with respect to the effectiveness of our internal control over financial reporting as of any date subsequent to December 31, 2006. Failure to maintain an effective internal control environment could have a material adverse effect on our business, financial condition and results of operations and the price of our common stock.

**The September 11 Events have had and may continue to have an adverse effect on our business.**

*Our losses*

Our previous headquarters were in the World Trade Center. As a result of the September 11 Events, our offices in the World Trade Center were destroyed, and we lost approximately 180 of our employees, including many members of our senior management. The destruction of our assets, the loss of all those employees, including product development personnel, and the relocation of the surviving employees have negatively impacted our business.

*Cantor's losses*

Cantor and TradeSpark lost an aggregate of 478 employees and critical equipment and systems as a result of the September 11 Events. Cantor also lost its headquarters. Such losses have negatively impacted our revenues and may continue to adversely impact our revenues in the future. While Cantor and/or BGC have rebuilt many of the trading desks in place prior to the September 11 Events, not all products historically traded using our eSpeed system have been replaced. In addition, the loss of Cantor's assets and brokers due to the September 11 Events continues to negatively affect the timing of our strategy to convert certain of the products that those brokers were trading in voice-assisted transactions to products that are traded fully electronically over our eSpeed system, or to provide integrated hybrid voice-assisted trading services to such voice-brokers.

**If we were to lose the services of members of management and employees who possess specialized market knowledge and technology skills, we may not be able to manage our operations effectively or develop new electronic marketplaces.**

Our future success depends, in significant part, on the continued service of Howard Lutnick, our Chairman, Chief Executive Officer and President, Lee Amaitis, our Vice Chairman, Paul Saltzman, our Chief Operating Officer, and our other executive officers, managers and sales and technical personnel who possess extensive knowledge and technology skills in our markets. We cannot assure you that we would be able to find an appropriate replacement for Mr. Lutnick or other executive officers if the need should arise. Any loss or interruption of Mr. Lutnick's services could result in our inability to manage our operations effectively and/or develop new electronic marketplaces. Messrs. Lutnick, Amaitis and Merkel also serve as executive officers of BGC, which has filed a registration statement reflecting its intention to become a publicly-traded company (the "BGC S-1"). In the event that BGC were to become a public company, Messrs. Lutnick, Amaitis and Merkel, as well as other officers and employees, may dedicate less of their professional efforts to our business and operations. The BGC S-1 also states that in the event that BGC were to become a public company, Mr. Amaitis may resign as an officer and director of eSpeed. We have not entered into employment agreements with any of our other executive officers or other personnel, including Mr. Lutnick or Mr. Amaitis. Although we have obtained \$15 million in key person life insurance on the life of Mr. Lutnick, we do not have key person life insurance policies on any of our other executive officers or personnel. Mr. Saltzman, while solely an employee of eSpeed, is also a partner of Cantor. Many of the other members of our senior management team are also officers, partners or key employees of Cantor or BGC and have, or will have in the future, substantial investments in Cantor or BGC through partnership ownership. As a result, many of such persons dedicate only a portion of their professional efforts to our business and operations. We cannot assure you that the time these persons devote to our business and operations in the future will be adequate and that we will not experience an adverse effect on our operations due to the demands placed on our management team by their other professional obligations. We intend to strive to provide high-quality services that will allow us to establish and maintain long-term relationships with our customers. Our ability to do so will depend, in large part, upon the individual employees who represent us in our dealings with customers. The market for qualified programmers, technicians and sales persons is extremely competitive and has grown more so in recent periods as electronic commerce has experienced growth. We cannot assure you that we will be successful in our efforts to recruit and retain the required personnel.



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### **If the value of the dollar against the other currencies in which we pay expenses continues to decline, our profitability could suffer.**

Because our business is global, dramatic changes in currency rates can impact our results. Significant downward movements in the U.S. Dollar against other currencies in which we pay expenses may have an adverse impact on our financial results if we do not have an equivalent amount of income denominated in the same currency. For example, the British Pound has appreciated significantly throughout 2006.

### **If adverse economic and political conditions occur, substantial declines in the U.S. and global financial services markets may result and our results of operations and profitability could suffer.**

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

economic and political conditions in the U.S. and elsewhere in the world;

terrorist attacks or war;

concerns over inflation and wavering institutional/consumer confidence levels;

the availability of cash for investment by mutual funds and other wholesale and retail investors;

fluctuating interest and exchange rates;

legislative and regulatory changes; and

currency values.

### **Because we expect to continue to expand our operations internationally, we may face special economic and regulatory challenges that we may not be able to meet.**

We operate integrated hybrid voice-assisted and fully electronic marketplaces throughout Europe and Asia and we plan to further expand our operations throughout these regions and other regions in the future. There are certain risks inherent in doing business in international markets, particularly in the regulated brokerage industry. These risks include:

less developed automation in exchanges, depositories and national clearing systems;

unexpected changes in regulatory requirements, tariffs and other trade barriers;

difficulties in staffing and managing foreign operations;

fluctuations in exchange rates;

reduced protection for intellectual property rights;

seasonal reductions in business activity during the summer months; and

potentially adverse tax consequences.

We are required to comply with the laws and regulations of foreign governmental and regulatory authorities of each country in which we conduct business. These may include laws, rules and regulations relating to any aspect of the securities business, including sales methods, capital structure, record-keeping, broker-dealer and employee registration requirements and the conduct of directors, officers and employees. Any failure to develop effective compliance and reporting systems could result in regulatory penalties in the applicable jurisdiction.

The growth of the Internet as a means of conducting international business has also raised many legal issues regarding, among other things, the circumstances in which countries or other jurisdictions have the right to regulate Internet services that may be available to their citizens from service providers located elsewhere. In many cases, there are no laws, regulations, judicial decisions or governmental interpretations that clearly resolve these issues. This uncertainty may adversely affect our ability to use the Internet to expand our international operations, and creates the risk that we could be subject to disciplinary sanctions or other penalties for failure to comply with applicable laws or regulations.

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### **As we enter new financial markets, we may not be able to successfully adapt our technology and marketing strategy for use in those markets.**

We are leveraging our eSpeed system to enter new financial markets. We cannot assure you that we will be able to successfully adapt our proprietary software, electronic distribution networks and technology for use in other markets. Even if we do adapt our software, networks and technology, we cannot assure you that we will be able to attract customers and compete successfully in any such new markets. We cannot assure you that our marketing efforts or our pursuit of any of these opportunities will be successful. If these efforts are not successful, we may realize less than expected earnings, which in turn could result in a decrease in the market value of our common stock. Furthermore, these efforts may divert management attention or inefficiently utilize our resources. We intend to create electronic marketplaces for many financial markets and extend into others, but there is no guarantee that we will be able to do so.

### **If we or our customers or affiliates acquire other companies, we may not be able to integrate their operations effectively.**

Our business strategy contemplates expansion through the acquisition of exchanges and other companies providing services or having technologies and operations that are complementary to ours. In addition, BGC has experienced significant growth through acquisitions of brokers both in the U.S. and abroad in recent periods. Acquisitions entail numerous risks, including:

difficulties in the assimilation of acquired operations and products;

diversion of management's attention from other business concerns;

assumption of unknown material liabilities of acquired companies;

amortization of acquired intangible assets, which would reduce future reported earnings; and

potential loss of customers or key employees of acquired companies.

We cannot assure you that we or our customers or affiliates will be able to integrate successfully any operations, personnel, services or products that might be acquired in the future, and the failure to do so could adversely affect our revenues and profitability.

### **Because our business is subject to extensive government and other regulation, we may face restrictions with respect to the way we conduct our operations and our customers and affiliates may be subject to limitations on their operations as a result of government regulation.**

The Securities and Exchange Commission, NASD, Commodity Futures Trading Commission and other agencies extensively regulate the U.S. financial industry. Our international operations may be or may become subject to similar regulations in specific jurisdictions. Certain of our U.S. subsidiaries are required to comply strictly with the rules and regulations of these agencies. As a matter of public policy, these regulatory bodies are responsible for safeguarding the integrity of the securities and other financial markets and protecting the interests of investors in those markets. Most aspects of our U.S. broker-dealer subsidiaries are highly regulated, including:

the way we deal with our customers;

our capital requirements;

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our financial and Securities and Exchange Commission reporting practices;

required record-keeping and record retention procedures;

the licensing of our employees; and

the conduct of our directors, officers, employees and affiliates.

If we or our affiliates, including Cantor or BGC, fail to comply with any of these laws, rules or regulations, we or our affiliates may be subject to censure, fines, cease-and-desist orders, suspension of our business, suspensions of personnel or other sanctions, including

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revocation of our registration as a broker-dealer. Changes in laws or regulations or in governmental policies could have a material adverse effect on the conduct of our business. These agencies have broad powers to investigate and enforce compliance and punish non-compliance with their rules and regulations. We cannot assure you that we and/or our directors, officers and employees will be able to fully comply with, and will not be subject to, claims or actions by these agencies.

The products and services we offer through our integrated hybrid voice-assisted and fully electronic marketplaces are likely to be regulated by federal, state and foreign governments. Our ability to provide such services will be affected by these regulations. In addition, as we expand our business to other financial markets, it is likely that we will be subject to additional federal, state and foreign regulations. The implementation of unfavorable regulations or unfavorable interpretations of existing regulations by courts or regulatory bodies could require us to incur significant compliance costs or cause the development of affected markets to become impractical.

Further, the Securities and Exchange Commission, NASD and various other regulatory agencies have stringent rules and regulations with respect to the maintenance of specific levels of net capital by regulated companies such as our subsidiaries, affiliates and customers. Net capital is the net worth of a broker or dealer, less deductions for certain types of assets. If a firm fails to maintain the required net capital, it may be subject to suspension or revocation of registration by the Securities and Exchange Commission or NASD, and suspension or expulsion by these regulators could ultimately lead to the firm's liquidation. If these net capital rules are changed or expanded, or if there is an unusually large charge against net capital, operations of our customers, affiliates or subsidiaries that require the intensive use of capital would be limited. Also, our ability to withdraw capital from broker-dealer subsidiaries could be restricted, which in turn could limit our ability to pay dividends, repay debt and redeem or purchase shares of our outstanding stock. A large operating loss or charge against net capital could adversely affect the ability to expand or even maintain our present levels of business by us, our customers and affiliates and subsidiaries, which could have a material adverse effect on our business. In addition, we may become subject to net capital requirements in foreign jurisdictions.

### **Because brokerage services involve substantial risks of liability, we may become subject to risks of litigation.**

Many aspects of our business, and the businesses of our customers, involve substantial risks of liability. Dissatisfied customers may make claims regarding quality of trade execution, improperly settled trades, mismanagement or even fraud against their service providers. We and our customers may become subject to these claims as the result of failures or malfunctions of systems and services provided by us, and third parties may seek recourse against us. We could incur significant legal expenses defending claims, even those without merit. An adverse resolution of any lawsuits or claims against us could result in our obligation to pay substantial damages.

### **If we cannot deter employee misconduct, we may be harmed.**

There have been a number of highly publicized cases involving fraud or other misconduct by employees in the financial services industry in recent years, and we run the risk that employee misconduct could occur. Misconduct by employees could include hiding unauthorized or unsuccessful activities from us. In either case, this type of conduct could result in unknown and unmanaged risks or losses. Employee misconduct could also involve the improper use of confidential information, which could result in regulatory sanctions and serious reputational harm. It is not always possible to deter employee misconduct, and the precautions we take to prevent and detect this activity may not be effective in all cases.

### **We cannot predict our future capital needs or our ability to secure additional financing.**

We anticipate, based on management's experience and current industry trends, that our existing cash resources will be sufficient to meet our anticipated working capital, capital expenditure and regulatory net capital requirements for at least the next 12 months. However, we believe that there are a significant number of capital intensive opportunities for us to maximize our growth and strategic position, including, among other things, acquisitions, joint ventures, strategic alliances, recapitalizations or other investments. As a result, we may need to raise additional funds to:

increase the regulatory net capital necessary to support our operations;

support more rapid growth in our business;

develop new or enhanced services and products;

respond to competitive pressures;

acquire complementary technologies;



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enter into strategic alliances, acquisitions or joint ventures or effect recapitalizations;

acquire companies with marketplace or other specific domain expertise; and

respond to unanticipated requirements.

We cannot assure you that we will be able to obtain additional financing when needed on terms that are acceptable, if at all.

**The market price of our Class A common stock has fluctuated and may fluctuate in the future, and future sales of our shares could adversely affect the market price of our Class A common stock. We have also repurchased our shares from time to time, and we may cease doing so at anytime.**

The market price of our Class A common stock has fluctuated widely since our initial public offering and may continue to fluctuate widely, depending upon many factors, including our actual results of operations and perceived prospects, the prospects of our competition and of the financial marketplaces in general, differences between our actual financial and operating results and those expected by investors and analysts, changes in analysts' recommendations or projections, seasonality, changes in general valuations for companies in our business segment, changes in general economic or market conditions and broad market fluctuations.

Future sales of our shares also could adversely affect the market price of our Class A common stock. If our existing stockholders sell a large number of shares, or if we issue a large number of shares of our common stock in connection with future acquisitions, strategic alliances, third-party investments and private placements or otherwise, the market price of our Class A common stock could decline significantly. Moreover, the perception in the public market that these stockholders might sell shares of Class A common stock could depress the market price of our Class A common stock.

We have registered under the Securities Act 30,000,000 shares of our Class A common stock, which are reserved for issuance upon exercise of options, restricted stock and other incentive compensation granted under our incentive compensation plan. These shares can be sold in the public market upon issuance, subject to restrictions under the securities laws applicable to resales by affiliates. In addition, we have registered under the Securities Act 425,000 shares of our Class A common stock issuable under our stock purchase plan. We also have from time to time issued new shares of our Class A common stock in connection with a matching program under our 401(k) plan. The maximum number of new shares issued in connection with our 401(k) plan is \$3,000 worth per eligible employee per year. However, we do not presently intend to provide such a matching program for calendar year 2007.

Since June 9, 2002, approximately 5.9 million shares of our Class A common stock that have been distributed to partners of Cantor as part of a deferred stock distribution by Cantor have been eligible for resale in the public market subject to Rule 144(k) under the Securities Act. The availability for sale of such number of shares may have an adverse effect on the market price of our Class A common stock.

In addition, we have issued shares of our Class A common stock, warrants and convertible preferred stock and have granted registration rights in connection with certain of our strategic alliances. See Item 13. Certain Relationships and Related Transactions.

During the year ended December 31, 2006, we repurchased an aggregate of 52,239 shares of our Class A common stock for a total of \$0.5 million. The reacquired shares have been designated treasury shares and will be used for general corporate purposes. As of December 31, 2006, our Board of Directors had authorized the repurchase of up to an additional \$58.2 million of our outstanding Class A common stock. We will consider making additional stock repurchases in 2007, and we may cease making repurchases at anytime.

## **RISKS RELATED TO OUR RELATIONSHIP WITH CANTOR, BGC AND THEIR RESPECTIVE AFFILIATES**

**Because we continue to depend on Cantor's and BGC's businesses, events which adversely affect Cantor's or BGC's business, or that of respective affiliates or customers, including a sale, dissolution, liquidation winding-up or recapitalization of Cantor or BGC, may have a material adverse effect on our revenues and profitability.**

Since inception, we have recognized a significant portion of our revenues in connection with our relationship with Cantor and its affiliates, including BGC, which was formed in October 2004. Consequently, our business was adversely affected by the effect of the September 11 Events on Cantor's business. See Risk Factors. The events of September 11, 2001 have had and may continue to have an adverse effect on our business. BGC and Cantor are our largest sources of revenue and accordingly, any other future events which adversely affect Cantor's or BGC's business or

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operating results, including a sale, dissolution, liquidation, winding-up or recapitalization of all or a material portion of Cantor's or BGC's business, could have a material adverse effect on our most significant source of revenues. We also are a general creditor of Cantor and BGC to the extent that there are transaction revenues and software

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solutions fees owing to us from those entities. Events that adversely affect Cantor's or BGC's financial position and its ability to remit to us our share of transaction revenues and software solutions fees could have a material adverse effect on our revenues and profitability.

**Conflicts of interest and competition with Cantor and BGC may arise.**

Various conflicts of interest between us and Cantor or BGC may arise in the future in a number of areas relating to our past and ongoing relationships, including potential acquisitions of businesses or properties, the election of new directors, payment of dividends, incurrence of indebtedness, tax matters, financial commitments, marketing functions, indemnity arrangements, service arrangements, issuances of our capital stock, sales to Cantor, BGC or third-party investors, or distributions by Cantor of its shares of our common stock and the exercise by Cantor of control over our management and affairs. Two of our directors and many of our officers also serve as directors, officers and/or partners of Cantor or BGC and/or their respective affiliates. Simultaneous service as an eSpeed director or officer and service as a director or officer of Cantor or BGC, or status as a partner of Cantor could create or appear to create potential conflicts of interest when such directors, officers and/or partners are faced with decisions that could have different implications for us and for Cantor or BGC. Mr. Lutnick, our Chairman, President and Chief Executive Officer, is the sole stockholder of the managing general partner of Cantor and indirectly of BGC and is also a partner of Cantor. As a result, Mr. Lutnick controls Cantor and BGC. Cantor owns shares of our Class A common stock and Class B common stock representing approximately 87.8% of the Total Voting Power of our capital stock. Similarly, our Vice Chairman, Lee Amaitis, is the Chairman and Chief Executive Officer of BGC and a partner of Cantor and may in the future be a partner in BGC. Although all related party transactions between eSpeed and Cantor, BGC and related entities are approved by our Audit Committee, Mr. Lutnick's simultaneous service as our Chairman, President and Chief Executive Officer and his control of Cantor and BGC as well as Mr. Amaitis' simultaneous service with us and BGC, as well as the Cantor partnerships interests held by both men, could create or appear to create potential conflicts of interest when Mr. Lutnick or Mr. Amaitis is faced with decisions that could have varying implications for us and for Cantor and BGC. In addition, in the event that BGC becomes a separate public company, certain decisions related to BGC may be made by a majority of BGC's independent directors for the benefit of BGC's public stockholders and may affect eSpeed and/or eSpeed's relationship with BGC.

Our relationship with Cantor and BGC results in agreements that are between related parties. As a result, the prices charged to us or by us for services provided under agreements with Cantor or BGC may be higher or lower than prices that may be charged by third parties and the terms of these agreements may be more or less favorable to us than those that we could have negotiated with third parties. However, transactions between us and Cantor, BGC and/or their other affiliates are subject to the approval of a majority of our Audit Committee, which is comprised of independent directors. In addition, Cantor and BGC can compete with us under certain circumstances.

**Because our Joint Services Agreement with Cantor and its affiliates has a perpetual term and contains non-competition provisions and restrictions on our ability to pursue strategic transactions, this agreement may become burdensome to our business.**

Although Cantor and BGC have agreed, subject to certain conditions, not to compete with us in providing electronic brokerage services, Cantor and BGC are currently engaged in securities transaction and other financial instruments execution and processing operations and other activities that are related to the electronic trading services we provide. Our Joint Services Agreement obligates us to perform technology support and other services for Cantor and its affiliates, including BGC, at cost, whether or not related to our electronic brokerage services, sets forth the ongoing revenue sharing arrangements between Cantor, including BGC, and its affiliates and us and subjects us and Cantor and its affiliates, including BGC, to non-competition obligations. The Joint Services Agreement precludes us from entering into lines of business in which Cantor, BGC and their affiliates, now or in the future may engage, or providing, or assisting any third party in providing, voice-assisted brokerage services, clearance, settlement and fulfillment services and related services, except under limited circumstances. Although we believe neither Cantor nor BGC has plans to form, acquire or commence any other operations similar to ours, the Joint Services Agreement permits Cantor and its affiliates, including BGC, to perform, in limited circumstances, electronic brokerage operations. In addition, the Joint Services Agreement imposes limitations on our ability to pursue strategic alliances, joint ventures, partnerships, business combinations, acquisitions and similar transactions. Because the Joint Services Agreement has a perpetual term, even in the event of a breach by one of the parties, and does not provide for unilateral modification under its terms, this agreement may become burdensome for us, may distract us from focusing on our internal operations, may deter or discourage a takeover of our company and may limit our ability to expand our operations.

**Because agreements between us and Cantor and its affiliates, including BGC, are between related parties, we may receive lower service fees from, and pay higher service fees to, Cantor and BGC than we would with respect to third-party service providers.**

In connection with the transactions which occurred when eSpeed was initially spun off from Cantor, we entered into Assignment and Assumption Agreements, an Administrative Services Agreement, a Joint Services Agreement and several other agreements with

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Cantor relating to the provision of services to each other and third parties, which agreements have been amended and revised from time to time, including agreements with respect to BGC. Because Cantor controls us, the prices charged to us or by us for services provided under the agreements may be higher or lower than prices that may be charged by third parties and the terms of these agreements may be generally less favorable to us than those that we could have negotiated with third parties.

**Because we depend on services and access to operating assets provided by third parties to Cantor and BGC, we may not have recourse against those third parties.**

Many of the assets and services provided by Cantor and BGC under the terms of the Administrative Services Agreement are leased or provided by third-party vendors. As a result, in the event of a dispute between Cantor or BGC and a third-party vendor, we could lose access to, or the right to use, as applicable, office space, personnel, corporate services and operating assets. In such a case, we would have no recourse with respect to the third-party vendor. Our inability to use these services and operating assets for any reason, including any termination of the Administrative Services Agreement between us and Cantor or the agreements between Cantor and third-party vendors, could result in serious interruptions of our operations.

**Our reputation may be affected by actions taken by Cantor or BGC and their affiliates.**

Cantor and BGC and their affiliates are currently our most significant customers. Cantor holds direct and indirect ownership and management interests in numerous other entities, including BGC, that engage in a broad range of financial services and securities-related activities. Actions taken by, and events involving, Cantor, BGC or their affiliates which are perceived negatively by our customers, the securities markets, or the public generally, could have a material adverse effect on our business, financial position, cash flows or operations or could affect the price of our Class A common stock. In the event that BGC becomes a separate public company in the U.S. certain decisions related to BGC may be made by a majority of BGC's independent directors for the benefit of BGC's public stockholders and may affect eSpeed and/or eSpeed's relationship with BGC. In addition, events that negatively affect the financial condition of Cantor or BGC may negatively affect us. These events could cause Cantor or BGC or their affiliates to lose customers that may trade in our marketplaces, could impair Cantor's or BGC's ability to perform its obligations under the Joint Services Agreement, the Administrative Services Agreement and other agreements Cantor or BGC enters into with us and could cause Cantor or BGC or their affiliates to liquidate investments, including by selling or otherwise transferring shares of our common stock.

**If we become subject to litigation and other legal proceedings, we may be harmed.**

From time to time, we and Cantor or BGC may become involved in litigation and other legal proceedings relating to claims arising from our and their operations in the normal course of business. Similarly, we may be subject to claims from time to time arising from our relationship with Cantor and its affiliates, including BGC, including as a result of any governmental action or actions as a result of any perceived or actual conflicts or interests or similar matters. We cannot assure you that these or other litigation or legal proceedings will not materially affect our ability to conduct our business in the manner that we expect or otherwise adversely affect us. See Item 3. Legal Proceedings.

## **RISKS RELATED TO OUR CAPITAL STRUCTURE**

**Because the voting control of our common stock is concentrated among the holders of our Class B common stock, the market price of our Class A common stock may be adversely affected by disparate voting rights.**

As of December 31, 2006, Cantor beneficially owned approximately 87.8% of the combined voting power of all classes of our voting stock. As long as Cantor beneficially owns a majority of the combined voting power of our common stock, it will have the ability, without the consent of the public stockholders, to elect all of the members of our Board of Directors and to control our management and affairs. In addition, it will be able to determine the outcome of matters submitted to a vote of our stockholders for approval and will be able to cause or prevent a change in control of our company. In certain circumstances, the shares of our Class B common stock issued to Cantor may be transferred without conversion to our Class A common stock.

The holders of our Class A common stock and Class B common stock have substantially identical rights, except that holders of our Class A common stock are entitled to one vote per share, while holders of our Class B common stock are entitled to 10 votes per share on all matters to be voted on by stockholders in general. These votes are controlled by Cantor and not subject to conversion or termination by our Board of Directors or any committee thereof, or any other shareholder or third-party. This differential in the voting rights and our ability to issue additional Class B common stock could adversely affect the market price of our Class A common stock.



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### **Delaware law and our charter may make a takeover of our company more difficult and dilute your percentage of ownership of our common stock.**

Provisions of Delaware law, such as its business combination statute, may have the effect of delaying, deferring or preventing a change in control of our company. In addition, our Amended and Restated Certificate of Incorporation authorizes the issuance of preferred stock, which our Board of Directors can create and issue without prior stockholder approval and with rights senior to those of our common stock, as well as additional shares of our Class B common stock and warrants to purchase our common stock. Any such issuances would make a takeover of our company more difficult and may dilute your percentage ownership of our common stock. Our Amended and Restated Certificate of Incorporation and our Second Amended and Restated By-Laws include provisions, which restrict the ability of our stockholders to take action by written consent and provide for advance notice for stockholder proposals and director nominations. These provisions may have the effect of delaying or preventing changes of control or management of our company, even if such transactions would have significant benefits to our stockholders. As a result, these provisions could limit the price some investors might be willing to pay in the future for shares of our Class A common stock.

### **Delaware law may protect decisions of our Board of Directors that have a different effect on holders of our Class A and Class B common stock.**

Stockholders may not be able to challenge decisions that have an adverse effect upon holders of our Class A common stock if our Board of Directors acts in a disinterested, informed manner with respect to these decisions, in good faith and in the belief that it is acting in the best interests of our stockholders. Delaware law generally provides that a board of directors owes an equal duty to all stockholders, regardless of class or series, and does not have separate or additional duties to either group of stockholders, subject to applicable provisions set forth in a company's charter.

## **ITEM 1B. UNRESOLVED STAFF COMMENTS**

Not applicable.

## **ITEM 2. PROPERTIES**

We have offices in the United States, United Kingdom and Asia. Our principal executive offices are located at contiguous space at 110 East 59<sup>th</sup> Street, New York, New York. For 2006, such rental expense is anticipated to be approximately \$1.8 million. Under the Administrative Services Agreement, we are obligated to Cantor for our pro rata portion (based on square footage used) of rental expense during the 16-year term of the lease for such spaces.

Our largest presence outside of the New York metropolitan area is in London. In the second quarter of 2006, we relocated our principal London office to 40 Bank Street, Canary Wharf.

We occupy a concurrent computing center in Rochelle Park, New Jersey and a Midwest data center in Chicago, Illinois. In March 2007, we plan to open an additional data center in Trumbull, Connecticut. Our U.S. operations also lease office space in Boston, Massachusetts, Chicago, Illinois, Dallas, Texas, Los Angeles, California and Shrewsbury, New Jersey. In addition to our London location, our foreign operations lease office space in Hong Kong and Singapore. We believe that our facilities are adequate for our current operations.

## **ITEM 3. LEGAL PROCEEDINGS**

In June 2003, we filed a patent infringement suit against BrokerTec USA, LLC, BrokerTec Global, LLC, its parent, ICAP, PLC, Garban, LLC, its technology provider, OM Technology, and its parent company, OM AB (collectively, BrokerTec), in the United States District Court for the District of Delaware. The suit centers on BrokerTec's and Garban's alleged infringement of the 580 Patent issued on May 6, 2003, which expires in 2016, with respect to which eSpeed is the exclusive licensee. The 580 Patent covers a system and methods for auction-based trading of specialized items such as fixed income instruments. In a pre-trial ruling on February 7, 2005, the Court ruled that the BrokerTec ETN did not infringe our 580 Patent. On February 22, 2005, the jury found that the Garban GTN did infringe our 580 Patent, but that there was a deficiency in the application which led to the 580 Patent. In Post-Trial Findings of Fact and Conclusions of Law dated February 22, 2006, the Court found that the 580 Patent was unenforceable due to inequitable conduct, but denied the defendants' request for an award of attorneys' fees. Final

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judgment was entered on April 3, 2006. By notice dated April 27, 2006, we appealed to the U.S. Court of Appeals for the Federal Circuit. Briefing of the appeal was completed on October 20, 2006. Oral arguments were held on January 8, 2007.

In August 2004, Trading Technologies International, Inc. ( TT ) commenced an action in the United States District Court, Northern District of Illinois, Eastern Division, against us. In its complaint, TT alleged that we infringe U.S. Patent No. 6,766,304, which issued on July 20, 2004, and U.S. Patent 6,772,132, which issued on August 3, 2004. TT later added eSpeed International and

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EccoWare LLC as defendants in a second amended complaint. On January 5, 2006, we answered TT's second amended complaint in which we denied the infringement allegations and we filed an amended counterclaim seeking a declaration that the patents in suit are invalid, we do not make, use or sell any product that infringes any claims of the patents in suit, the patents in suit are unenforceable because of inequitable conduct before the U.S. Patent and Trademark Office during the prosecution of the patents, and the patents are unenforceable due to TT's patent misuse. Discovery is ongoing, and the Court consolidated for certain discovery and Markman hearing purposes our case with other patent infringement cases brought by TT against other defendants. A Markman hearing was held on August 16-18, 2006. On October 31, 2006, the Court issued a ruling on claim construction, which provides the meanings of the various terms in dispute in the asserted patents. In that ruling, the Court found that we correctly defined several of the patents' key terms. The Court's ruling supports our consistent position that eSpeed and ECCO's products fall outside the scope of Trading Technologies' patents. However, the litigation is ongoing, and as with all litigation, the outcome is uncertain. Consequently, if TT ultimately prevails, we may be required to pay TT damages and/or certain costs and expenses, and we may be forced to modify or withdraw certain products from the market. Currently the trial date is set for June 7, 2007. Both parties requested attorneys' fees from the other party, which may be awarded by the Court in exceptional cases. The Company is unable to estimate a possible loss or range of losses in connection with this matter.

In addition to the matters discussed above, the Company is involved in other legal proceedings that have arisen in the ordinary course of business.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

On December 14, 2006, we held our annual meeting of stockholders. At the meeting, the following directors were elected by the stockholders to hold office until the next annual meeting or until their successors have been duly elected and qualified: Howard W. Lutnick, Lee M. Amaitis, John H. Dalton, Barry R. Sloane and Albert M. Weis.

The votes with respect to the election were cast in the following manner:

NAME	FOR	(Number of Votes)	WITHHELD
Howard W. Lutnick	223,393,985		8,844,775
Lee M. Amaitis	223,453,228		8,785,532
John H. Dalton	231,723,692		515,068
Barry R. Sloane	231,901,329		331,431
Albert M. Weis	231,711,408		527,352

**PART II****ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES****Price Range of Class A Common Stock**

Our Class A common stock is traded on the NASDAQ Global Market under the symbol ESPD. For each quarter of the prior two years and through March 13, 2007, the high and low sales prices for our Class A common stock, as reported by NASDAQ, were as follows:

	High	Low
<b>2007</b>		
First Quarter (through March 13, 2007)	\$ 9.23	\$ 7.22
<b>2006</b>		
First Quarter	\$ 9.57	\$ 7.47
Second Quarter	\$ 8.55	\$ 7.15
Third Quarter	\$ 9.23	\$ 7.47



Fourth Quarter

\$ 10.45

\$ 8.45

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2005		
First Quarter	\$ 12.58	\$ 8.13
Second Quarter	\$ 9.25	\$ 7.65
Third Quarter	\$ 9.11	\$ 7.50
Fourth Quarter	\$ 8.71	\$ 6.73

On March 13, 2007, the last reported closing price of our Class A common stock on the NASDAQ Global Market was \$8.73. As of March 13, 2007, there were 382 holders of record of our Class A common stock and two holders of record of our Class B common stock.

**Dividend Policy**

We intend to retain our future earnings, if any, to help finance the growth and development of our business. We have never declared or paid a cash dividend on our common stock and we do not expect to pay any cash dividends on our common stock in the foreseeable future.

In the event we decide to declare dividends on our common stock in the future, such declaration will be subject to the discretion of our Board of Directors. Our Board of Directors may take into account such matters as general business conditions, our financial results, capital requirements, contractual, legal and regulatory restrictions on the payment of dividends by us to our stockholders or by our subsidiaries to us and any such other factors as our Board of Directors may deem relevant.

**Issuer Purchases of Equity Securities**

On August 5, 2004, our Board of Directors authorized the repurchase of up to \$100 million of outstanding Class A common stock to replace the remaining \$20.5 million authorized from the prior plan. As of December 31, 2006, approximately \$58.2 million from this plan was available for further share repurchases. As of December 31, 2006, we have repurchased an aggregate of 6.6 million shares of our Class A common stock for a total purchase price of approximately \$63.4 million. For the year ended December 31, 2006, we repurchased an aggregate of 52,239 shares of our Class A common stock for a total purchase price of approximately \$0.5 million. The reacquired shares have been designated treasury shares and will be used for general corporate purposes. We may consider making additional stock repurchases in 2007.

The following table details our share repurchase activity during the fourth quarter of 2006, including the total number of shares purchased, the average price paid per share, the number of shares repurchased as part of our publicly announced plans and the approximate dollar value that may yet be purchased under these plans:

	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Approximate Dollar Value of Shares that May Yet be Purchased Under the Program
Oct. 1, 2006 through Oct. 31, 2006				\$
Nov. 1, 2006 through Nov. 30, 2006				\$
Dec. 1, 2006 through Dec. 31, 2006	52,239	\$ 8.92	52,239	\$ 58.2 million

**ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA**

The following table sets forth selected consolidated financial data for the last five years ended December 31, 2006. This selected consolidated financial data should be read in conjunction with Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and our Consolidated Financial Statements and the accompanying Notes thereto included elsewhere in this Report. This data has been restated to reflect adjustments described in Note 21 to Consolidated Financial Statements included in Item 8 of this Form 10K/A.

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	Restated Year Ended December 31, (see note 21)				
	2006	2005	2004	2003	2002
	(in thousands)				
Total revenues	\$ 164,683	\$ 151,834	\$ 165,299	\$ 155,815	\$ 138,614
Expenses:					
Compensation and employee benefits	52,765	50,633	40,671	36,114	36,499
Occupancy and equipment:					
Amortization of software development costs and other intangibles	23,811	20,093	16,310	12,906	9,015
Other occupancy and equipment	37,280	30,678	25,202	23,733	19,173
Professional and consulting fees	9,464	8,788	5,594	3,519	5,658
Impairment of long-lived assets	1,861	2,386	6,268		
Communications and client networks	8,101	8,157	6,487	6,714	6,335
Marketing	852	1,596	1,442	1,454	4,778
Administrative fees to related parties	12,598	13,938	13,228	10,442	9,134
Amortization of business partner and non-employee securities	19	318	856	2,167	2,059
Acquisition-related costs	2,026	3,327			
Loss on unconsolidated investments					950
Provision for September 11, 2001 events					(1,200)
Other expenses	8,289	9,896	8,219	6,334	4,380
Total operating expenses	157,066	149,810	124,277	103,383	96,781
Income before income taxes	7,617	2,024	41,022	52,432	41,833
Provision for income taxes	2,965	490	16,036	16,059	478
Net income	\$ 4,652	\$ 1,534	\$ 24,986	\$ 36,372	\$ 41,355
Per share data:					
Basic earnings per share	\$ 0.09	\$ 0.03	\$ 0.45	\$ 0.66	\$ 0.75
Diluted earnings per share	\$ 0.09	\$ 0.03	\$ 0.44	\$ 0.63	\$ 0.73
Basic weighted average shares of common stock outstanding	50,214	51,349	54,978	55,345	54,991
Diluted weighted average shares of common stock outstanding	51,258	52,066	56,318	57,499	56,784
Cash and cash equivalents	\$ 187,847	\$ 178,435	\$ 209,688	\$ 228,500	\$ 187,999
Total assets	293,073	280,934	310,092	297,602	252,749
Total liabilities	39,994	37,188	41,726	26,901	35,554
Total stockholders' equity	253,079	243,746	268,366	270,701	217,195

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**ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

***Introduction***

This discussion summarizes the significant factors affecting our results of operations and financial condition during the years ended December 31, 2006, 2005 and 2004. This discussion is provided to increase the understanding of, and should be read in conjunction with, our Consolidated Financial Statements and the accompanying Notes thereto included elsewhere in this Report. This discussion gives effect to the restatement discussed in Note 21 to the Consolidated Financial Statements included in Item 8 of this Annual Report on Form 10-K/A.

**Discussion of Forward-Looking Statements**

The information in this report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Such statements are based upon current expectations that involve risks and uncertainties. Any statements contained herein that are not statements of historical fact may be deemed to be forward-looking statements. For example, words such as may, will, should, estimates, predicts, potential, continue, strategy, believes, anticipate, intends and similar expressions are intended to identify forward-looking statements.

On May 29, 2007, the Company announced that it had entered into an Agreement and Plan of Merger, dated as of May 29, 2007, with BGC Partners, Inc. ( BGC ); Cantor Fitzgerald, L.P. ( Cantor ); BGC Partners, L.P., a Delaware limited partnership; BGC Global Holdings, L.P., a Cayman Islands exempted limited partnership; and BGC Holdings, L.P., a Delaware limited partnership pursuant to which eSpeed will acquire BGC through a merger of BGC with and into eSpeed. For more information, see eSpeed's Report on Form 8-K dated May 29, 2007.

The actual results of eSpeed, BGC or the combined company in the merger ( we , our , or the combined company ) and the outcome and timing of certain events may differ significantly from the expectations discussed in the forward-looking statements. Factors that might cause or contribute to such a discrepancy for eSpeed, BGC and/or the combined company include, but are not limited to, our relationship with Cantor and its affiliates and any related conflicts of interests, competition for and retention of brokers and other managers and key employees, pricing and commissions and market position with respect to any of our products, and that of the our respective competitors, the effect of industry concentration and consolidation, and market conditions, including trading volume and volatility, as well as economic or geopolitical conditions or uncertainties. Results may also be impacted by the extensive regulation of our respective businesses and risks relating to compliance matters, as well as factors related to specific transactions or series of transactions, including credit, performance and unmatched principal risk as well as counterparty failure. Factors may also include the costs and expenses of developing, maintaining and protecting intellectual property, including judgments or settlements paid or received in connection with intellectual property or employment or other litigation and their related costs, and certain financial risks, including the possibility of future losses and negative cash flow from operations, risks of obtaining financing and risks of the resulting leverage, as well as interest and currency rate fluctuations.

Discrepancies may also result from such factors as the ability to enter new markets or develop new products, trading desks, marketplaces or services and to induce customers to use these products, trading desks, marketplaces or services, to secure and maintain market share, to enter into marketing and strategic alliances, and other transactions, including acquisitions, dispositions, reorganizations, partnering opportunities, and joint ventures, and the integration of any completed transactions, to hire new personnel, to expand the use of technology for screen-assisted, voice-assisted and fully electronic trading and to effectively manage any growth that may be achieved. Results are also subject to risks relating to the proposed merger and separation of the BGC businesses and the relationship between the various entities, financial reporting, accounting and internal control factors, including identification of material weaknesses in our internal controls, our ability to prepare historical and pro forma financial statements and reports in a timely manner, and other factors, including those that are discussed under Risk Factors in this Annual Report on Form 10-K/A for the year ended December 31, 2006 filed with the Securities and Exchange Commission (the SEC ) on August 22, 2007 and BGC's Registration Statement on Form S-1 filed with the SEC on February 8, 2007 (Registration No. 333-140531) to the extent applicable.

We believe that all forward-looking statements are based upon reasonable assumptions when made. However, we caution that it is impossible to predict actual results or outcomes or the effects of risks, uncertainties or other factors on anticipated results or outcomes and that accordingly you should not place undue reliance on these statements. Forward-looking statements speak only as of the date when made and we undertake no obligation to update these statements in light of subsequent events or developments.

**Restatement**

Subsequent to the issuance of the Company's consolidated financial statements for the year ended December 31, 2006, management became aware that certain revenues and expenses related to a portion of the development of related party software covered under the Company's Joint Services Agreement (the JSA ) with Cantor required restatement. The Company had accounted for certain fees paid by related parties for

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software development as revenue in the period when the cash was received. The Company has now concluded that some of these paid fees should have been deferred and recognized ratably over the future period when such software will be used to provide services to Cantor. The restatement correction reduces revenue from current periods, thereby creating a deferred revenue liability. The restatement also corrects the amortization expense that was recorded in connection with the determination of the period of benefit provided by the developed software.

Specifically, Software Solutions fees from related parties revenue has been restated to defer recognition over the period in which such fees are earned. Accordingly, the Company has restated its previously reported consolidated financial statements for the years ended December 31, 2006, 2005 and 2004, and all related financial information and disclosures, as well as its interim financial data for all interim periods of 2006 and 2005. See Note 21 of Notes to Consolidated Financial Statements.

The effects of the restatement are reflected in the table below. Additionally, the Consolidated Statements of Stockholders' Equity reflect a decrease in the Company's retained earnings of \$1.5 million as of January 1, 2004. The restatement had no effect on net cash flows from operating, investing or financing activities as shown in the Consolidated Statements of Cash Flows.

December 31	2006		2005			
(In thousands)	Previously Reported	Restated	Previously Reported	Restated		
<b>Consolidated Balance Sheets:</b>						
Fixed assets, net	57,207	57,443	58,291	58,291		
Total assets	292,837	293,073	280,934	280,934		
Accounts payable and accrued liabilities	25,836	24,129	19,649	17,591		
Deferred income	4,075	8,114	7,593	12,010		
Total liabilities	37,662	39,994	34,830	37,188		
Retained earnings	17,521	15,425	14,631	12,273		
Total Liabilities and Stockholders' Equity	292,837	293,073	280,934	280,934		
<b>Year ended December 31</b>						
(In thousands, except per share data)	2006		2005		2004	
	Previously Reported	Restated	Previously Reported	Restated	Previously Reported	Restated
<b>Consolidated Statements of Income:</b>						
Software Solutions fees from related parties	30,445	30,822	25,818	24,709	18,642	17,432
Total revenue	164,306	164,683	152,943	151,834	166,509	165,299
Amortization of software development costs	24,047	23,811	20,134	20,093	16,235	16,310
Total operating expenses	157,302	157,066	149,851	149,810	124,202	124,277
Income before income taxes	7,004	7,617	3,092	2,024	42,307	41,022
Provision for Income Taxes	2,614	2,965	1,048	490	16,457	16,036
Net income	4,390	4,652	2,044	1,534	25,850	24,986
Basic earnings per share	\$ 0.09	\$ 0.09	\$ 0.04	\$ 0.03	\$ 0.47	\$ 0.45
Diluted Earnings per share	\$ 0.09	\$ 0.09	\$ 0.04	\$ 0.03	\$ 0.46	\$ 0.44

### Overview

For a description and overview of our business, industry, products and strategy, see Item 1. Business.

Our overall financial results in 2006 were an improvement over 2005, as we experienced an increase in revenues and doubling of net income. The revenue increase was driven by continued year-over-year growth in our hybrid voice and screen-assisted businesses and Software Solutions. Additionally and significantly, Wagner patent-related revenues grew substantially over 2005, and we received gains from September 11<sup>th</sup>-related replacement insurance and government grant income from related parties. These results were offset by lower U.S. Treasury revenues as our customers continued the transition to fixed fee pricing from a variable fee commission model, increased expenses from our continued investment in new products and technology, and significant one-time London office relocation costs.

We expect lower revenue and net income in 2007. The Wagner patent, which contributed 2006 fully-electronic revenues from unrelated parties and Software Solutions of \$6.2 million and \$11.7 million, respectively, expired on February 20, 2007. After this date, we will no longer receive revenue from this patent. While we have some uncertainty regarding our licensing fee revenues, we have a broad intellectual property patent portfolio that we believe is highly valuable. We do not foresee any further September 11<sup>th</sup>-related replacement insurance or government grant income. We expect our new products revenue to advance from 2006 levels, but may not contribute significant revenue growth. Our hybrid voice and screen-assisted businesses have been growing since 2004 due to the continued expansion of our affiliated voice-brokers, and we anticipate growth for 2007 as well. As such, we currently expect to experience expense levels consistent with 2006 as we continue to invest in technology to support our affiliated voice-brokers, and anticipated progression of our new products.

**U.S. Treasuries**

We consider the trading of U.S. Treasury securities to be both a foundation for our Company and an area for potential incremental growth. During 2006, we experienced growth in our overall trading volumes. We believe this growth was the result of a solid foundation of customer relationships, our proprietary technology, the continuation of fixed price arrangements with our largest

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customers, and the impact of trading incentives at marginally lower commissions contained in many of our tailored pricing arrangements. Despite our increased trading volumes, our fully electronic revenue per transaction declined during 2006. This decline was due to an increase in trading volumes among those customers with fixed fee pricing contracts.

We remain well positioned for the projected growth in the overall U.S. Treasury market. With computer-assisted trading being the primary factor, we expect U.S. Treasury volumes to continue to grow substantially as traders utilize computers to augment and implement their trading strategies. Our pipeline of new computer driven customers and relationships with these new market participants remain strong, assisted by our proprietary technology, customized client-centric approach and dedicated sales and technology teams. As with most of our new clients, computer-assisted traders usually commence trading under variable price arrangements, so that early growth from these incremental traders will add both volume and variable revenue. However, as these clients develop their trading model and execute more trades, the trend is for these customers to migrate to a customized pricing arrangement that may include a fixed component as well as some variable components.

### **Hybrid Voice and Screen-Assisted Products**

BGC's continued growth and expansion resulted in revenue growth in 2006 across our hybrid voice-assisted and screen-assisted businesses compared with 2005, and continues to present us with significant opportunities globally.

Over the last two years, BGC has acquired Maxcor Financial Group, Inc. ( Maxcor ), a domestic and international inter-dealer broker for a broad range of financial instruments, and ETC Pollak ( Pollak ) and Aurel Leven Securities ( Leven ), two of France's leading inter-dealer brokers. As a result, Maxcor's, Pollak's and Leven's brokerage transactions are subject to the terms and conditions of the JSA.

Our revenue for voice-assisted transactions grew at a slower rate than screen-assisted open outcry transactions as the integration of certain BGC brokering desks in 2005 resulted in their volumes moving from voice-assisted brokerage into Maxcor's screen-assisted and open outcry desks. Now that the integration process is complete and we are implementing technology improvements across many of BGC's trading desks, we expect over time that some of the voice-only desks, where we receive no revenue share, will become 2.5% revenue share screen-assisted desks, and for some of the current 2.5% screen-assisted desks to become 7% revenue share voice-assisted desks. For 2006, a portion of the growth in screen-assisted revenue has come from such migration.

Our hybrid model provides us a significant long-term pipeline opportunity, both in terms of fully electronic transaction volume and for increased revenues across our product offerings. The lifecycle of our hybrid model is the maturity of a marketplace from telephones to computer-assisted trading. Historically, new markets have initially tended to trade by voice alone. As volumes increase and the structure and characteristics of a market standardize over time, the potential to leverage technology and create new hybrid and fully electronic traded products increases, thereby allowing us to generally capture up to 65% revenue share versus 7% for voice-assisted products. For example, in the first quarter of 2007; we have launched a fully electronic BGC-branded European credit default swaps trading platform. Also in 2007, we anticipate BGC's FX Options business adding a fully electronic component. There is uncertainty however, regarding the pace at which individual markets or financial instruments migrate from voice-only to computer-assisted and fully electronic trading.

### **New Products**

With our existing relationships, technology, network and prime location on trader desktops, we have the ability to extend our product-line beyond U.S. treasuries and hybrid voice markets. In 2006, despite nominal new products revenues, we experienced strong growth in trading volume. We remain committed to growing, developing and fostering our new products and investments such as foreign exchange, futures and equities.

### **Foreign exchange:**

With regard to foreign exchange, we offer a trading platform that provides FX spot traders with what we believe is a better way to trade. However, we experienced marginal growth in 2006 as we continued to encounter difficulties sustaining application programming interface ( API ) delivered price support from market-makers. Accordingly, we are making strategic adjustments that include the deployment of a complementary second platform targeted at major liquidity providers and market-makers. We believe that this new platform, combined with our experienced sales team and the continued growth in algorithmic trading and desktop traders, has us well-positioned to capitalize on this opportunity. Additionally, we added an industry veteran as Global Head of Electronic Foreign Exchange.

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### **Futures:**

Our futures business comprises an order routing service that offers customers access to the futures markets over the eSpeed network, and the ECCO front-end trading software product that provides sophisticated trading tools such as automated spreading. During 2006, we focused on improving the structure and scalability of our current business, as well as investing in new product offerings and services. This investment has produced a new faster order routing connection to the CBOT futures exchange. Enhancements to the ECCO product suite, such as faster links to the Eurex exchange and a new link to the ICE Futures exchange, will allow us to offer customers market leading automated spreading capabilities for both the Eurex and ICE markets. We also improved our support and logging tools providing more efficiency and scalability to our support service.

In addition, we continue to market our unique platform where certain kinds of trading in cash U.S. Governments and futures may be executed simultaneously. This allows us to capture more of a trader's government bond trades by satisfying futures trading needs on the same platform. Through our ongoing strategy to increase distribution of our front-end products and expansion of our API service for connection of customers own applications to the eSpeed network, we aim to further increase volumes traded on the eSpeed network.

### **Equities:**

In January 2007, we announced the formation of Aqua Equities ( Aqua ), an alternative electronic trading platform offering new pools of block liquidity to the global equities markets. Aqua will initially be 51% owned by Cantor and 49% owned by us. Both companies collectively will contribute financial, professional, and technology assets to the new venture, which will include all of eSpeed's former equities order routing business. We also expect Aqua to offer investment opportunities to a small number of strategic partners. Concurrent with this announcement, Kevin Foley relinquished his role as President of eSpeed, and will lead this initiative as President and CEO of Aqua.

### **Operations**

We remain a leading innovator in the provision of financial product trading technology. In 2006, we devoted significant energy to the development of new and proprietary methods and technologies that we expect to incorporate in new products and product enhancements in 2007 and beyond. We target our innovation to create new opportunities for our clients to gain trading advantage and increase trading profits and to meet new client needs that are generated by the rapid pace of change in their businesses. We believe that such continued delivery of new technologies that add value to our clients will create for us additional trading volume, new revenue opportunities and barriers against competition.

We increased our expenses in 2006 mainly as a result of our continued investment in technology professionals and our London office relocation costs. There were also increased depreciation expenses from IT equipment purchases as we continued to invest in our technical platform to support the growth of our fully-electronic businesses and the continuing growth of our affiliated voice brokerages. Additionally, we recorded increased compensation expenses associated with the adoption of SFAS No. 123(R), Share-Based Payments.

We expect lower revenue and net income for 2007, primarily due to the expiration of the Wagner Patent on February 20, 2007. After this date, the Company will no longer receive revenue or have any expense from this patent. Revenues from the Wagner Patent aggregated \$17.9 million, \$11.3 million and \$9.7 million for the years ended December 31, 2006, 2005 and 2004, respectively. Additionally, Wagner Patent related amortization expenses were \$4.8 million for each of the three years. For 2007, we anticipate expense levels consistent with 2006 as we continue to devote significant resources to the innovation and development of technology to further the evolution of our significant long-term hybrid pipeline and new products.

### ***Critical Accounting Policies and Estimates***

The following discussion is based upon our Consolidated Financial Statements and the accompanying Notes thereto, which have been prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ). The preparation of these Consolidated Financial Statements requires us to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. We regularly evaluate our estimates and assumptions related to stock-based compensation expense, goodwill and purchased intangible assets valuations, strategic investments, deferred income tax asset valuation allowances, restructuring costs, litigation and other loss contingencies. We base our estimates and assumptions on current facts, historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the accrual of costs and expenses that are not readily apparent from other sources. The actual results experienced by us may differ materially and adversely from our estimates. To the extent there are material differences between our estimates and the actual results, our future



results of operations will be affected.

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We believe that the following critical accounting policies affect our more significant estimates and judgments used in the preparation of our Consolidated Financial Statements and the accompanying Notes thereto.

### **Related party transactions**

We share revenues with Cantor, BGC, Freedom and CO2e.com, LLC ( CO2e ). In addition, we provide technology support services to Cantor, BGC, Freedom and CO2e, and Cantor provides administrative services to us.

Since Cantor holds a controlling interest in us, and holds a significant interest in BGC and Freedom, such transactions among and between us and Cantor, BGC, Freedom and CO2e are on a basis that might not be replicated if such services or revenue sharing arrangements were between, or among, unrelated parties.

We recognize Software Solutions fees from related parties based on the allocated portion of our costs of providing services to our related parties. Such allocation of costs requires us to make estimates and judgments as to the equitable distribution of such costs. In addition, we receive administrative services from Cantor, for which we pay a fee based on Cantor's good faith determination of an equitable allocation of the costs of providing such services. There is no assurance that we could realize such revenues or obtain services, at such costs, if we had to replicate such arrangements with unrelated parties.

### **Related Party Software Development Services Revenue Recognition**

We receive Software Solutions fees for the development of related party computer software. Upfront fees are deferred and recognized ratably over the future period during which such software will be used to provide services to the related party.

### **Patents**

Intangible assets consist of purchased patents, costs incurred in connection with the filing and registration of patents and the costs to defend and enforce our rights under patents. Capitalized costs related to the filing of patents are generally amortized on a straight-line basis over a period not to exceed three years. The costs of acquired patents are amortized over a period not to exceed 17 years or the remaining life of the patent, whichever is shorter, using the straight-line method. The costs to defend and enforce our rights under these patents consist primarily of external litigation costs related to the pursuit of patent infringement lawsuits by us, and consist of fees for outside attorneys, technology experts and litigation support services. These costs are capitalized when such costs serve to enhance the value of the related patent, and are amortized over the remaining life of such patent. Should it be determined that the capitalized costs no longer serve to enhance the value of the related patent, such as a situation in which our patent is held to be invalid, these capitalized costs would be expensed in the period in which such determination was made. We believe the inherent value of the patents exceeds their carrying value. However, if the rights afforded us under the patents are not enforced or the patents do not provide the competitive advantages that we anticipated at the time of purchase, we may have to write-down the patents, and such charges could be substantial. See Note 5, Goodwill and Other Intangible Assets, and Note 9, Commitments and Contingencies, of the accompanying Notes to Consolidated Financial Statements for further discussion.

### **Goodwill and Indefinite Lived Intangible Assets**

We review goodwill and indefinite lived intangible assets for impairment annually in the fourth quarter and whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 142, Goodwill and Other Intangible Assets. Goodwill is the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations accounted for as a purchase. Goodwill is no longer amortized, but instead is subject to periodic testing for impairment. Goodwill impairment is determined using a two-step approach. The first step of the goodwill test compares the fair value of a reporting unit with its carrying amount, including goodwill. The second step of the goodwill impairment test compares the implied fair value of the reporting unit's goodwill with the carrying amount of that goodwill. If the carrying amount of the reporting unit's goodwill exceeds the implied fair value of that goodwill, an impairment loss is recognized in an amount equal to that difference.

Determining the fair value of goodwill assets is judgmental in nature and involves the use of estimates and assumptions. We base our fair value estimates on assumptions we believe to be reasonable. Actual future results may differ from those estimates.

### **Long Lived Assets**

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We review long-lived assets, such as property, plant, and equipment, and definite lived intangible assets subject to amortization, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long Lived Assets ( SFAS 144 ). Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of the asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the assets. We recognized impairment charges for long-lived assets of \$1.9 million, \$2.4 million and \$6.3 million for the year ended December 31, 2006, 2005 and 2004, respectively. See Note 4, Fixed Assets, and Note 5, Goodwill and Other Intangible Assets, of the accompanying Notes to the Consolidated Financial Statements for more information regarding these impairment charges.

**Table of Contents****Fixed Assets**

We carry fixed assets at cost net of accumulated depreciation. Fixed assets, principally composed of computers, communication equipment and software, are depreciated over their estimated economic useful lives (generally three to seven years) using the straight-line method. Internal and external direct costs of application development and of obtaining software for internal use are capitalized and amortized over their estimated economic useful life (generally three years) on a straight-line basis. Leasehold improvements are amortized over their estimated economic useful lives, or the remaining lease term, whichever is shorter. Routine repairs and maintenance are expensed as incurred.

**Income Taxes**

SFAS No. 109, Accounting for Income Taxes, establishes financial accounting and reporting standards for the effect of income taxes. The objectives of accounting for income taxes are to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in an entity's financial statements or tax returns. Estimates and judgment are required in assessing the future tax consequences of events that have been recognized in our financial statements or tax returns.

**RESULTS OF OPERATIONS****Revenues**

The following table sets forth certain Consolidated Statements of Income data, as restated, expressed as a percentage of net revenue for the periods indicated:

	Year Ended December 31, 2006	Percentage of Total Revenue	Year Ended December 31, 2005	Percentage of Total Revenue	Year Ended December 31, 2004	Percentage of Total Revenue
	(in thousands)					
Transaction revenues						
Fully electronic transactions with related parties	\$ 62,084	37.7%	\$ 74,669	49.2%	\$ 108,033	65.4%
Fully electronic transactions with unrelated parties	6,937	4.2%				
Total fully electronic transactions	69,021	41.9%	74,669	49.2%	108,033	65.4%
Voice-assisted brokerage transactions with related parties	26,043	15.8%	25,192	16.6%	22,125	13.4%
Screen-assisted open outcry transactions with related parties	5,675	3.4%	2,863	1.9%	846	0.5%
Total transaction revenues	100,739	61.2%	102,724	67.7%	131,004	79.9%
Software Solutions fees from related parties, restated	30,822	18.7%	24,709	16.3%	17,432	10.5%
Software Solutions and licensing fees from unrelated parties	16,981	10.3%	15,534	10.2%	13,418	8.1%
Insurance recovery from related parties	3,500	2.1%	1,692	1.1%		
Grant income	3,100	1.9%				
Gain on sale of investments			1,015	0.7%		
Interest income, restated	9,541	5.8%	6,160	4.1%	3,445	2.1%
Total revenues	\$ 164,683	100.0%	\$ 151,834	100.0%	\$ 165,299	100.0%

**Table of Contents****Revenues Comparison of the years ended December 31, 2006 and 2005***Total transaction revenues*

Total transaction revenues for 2006 were \$100.7 million compared with \$102.7 million in 2005. There were 250 trading days in both years. Fully-electronic and voice-assisted volumes transacted increased by \$28,371 billion (approximately \$28.4 trillion), or 40.8%, to \$97,915 billion (approximately \$97.9 trillion) for 2006 from \$69,544 billion (approximately \$69.5 trillion) for 2005. During 2006, fully electronic, voice-assisted and screen-assisted transaction revenues contributed 68.5%, 25.9% and 5.6% of our total transaction revenues, respectively, compared with 72.7%, 24.5% and 2.8% respectively, in 2005.

Fully electronic transaction revenues with related parties for 2006 were \$62.1 million, a \$12.6 million or 16.9% decrease from \$74.7 million in 2005. This decrease was primarily the result of our customers' continued transition to fixed fee pricing from a variable fee commission model. This decline was partially offset by higher trading volumes on the eSpeed platform of \$42.2 trillion for 2006 compared with \$30.9 trillion for 2005.

For the year ended December 31, 2006, fully electronic transaction revenues with unrelated parties were \$6.9 million, of which \$6.2 million related to Wagner Patent transactions. The Wagner Patent expired on February 20, 2007.

Voice-assisted brokerage revenues with related parties for 2006 were \$26.0 million, an increase of 3.4% from \$25.2 million in 2005. This increase was primarily due to BGC's investment and expansion in the voice brokerage business partially offset by the effects of desk consolidations following the Maxcor acquisitions.

Screen-assisted open outcry revenues with related parties for 2006 were \$5.7 million, an increase of 98.2% from \$2.9 million in 2005. The increase was primarily due to BGC's investment and expansion in the voice brokerage business and BGC's trading desks migrating to screen-assisted open outcry from voice only desks.

Our revenues are highly dependent on transaction volume in the global financial product trading markets. Accordingly, among other things, equity and interest rate market volatility, economic and political conditions in the United States and elsewhere in the world, concerns over inflation, institutional and consumer confidence levels, the availability of cash for investment by mutual funds and other wholesale and retail investors, fluctuating interest and exchange rates and legislative and regulatory changes and currency values may have an impact on our volume of transactions. In addition, a significant amount of our revenues is currently received in connection with our relationship with related parties, primarily Cantor.

*Software Solutions fees from related parties*

Software Solutions fees from related parties for 2006 were \$30.8 million compared with \$24.7 million in 2005, an increase of 24.7%. This increase resulted from an increase in demand for our support services due to the growth of both the Cantor and BGC businesses.

*Software Solutions and licensing fees from unrelated parties*

Software Solutions and licensing fees from unrelated parties for 2006 were \$17.0 million compared with \$15.5 million in 2005, an increase of 9.3%. This increase was primarily due to additional Wagner Patent fees as we earned revenues of approximately \$11.7 million in 2006 as compared with \$10.0 million in 2005. The Wagner Patent expired on February 20, 2007. While we have some uncertainty regarding our licensing fee revenues, we have a broad intellectual property patent portfolio that we believe is highly valuable. See Note 5, Goodwill and Other Intangible Assets, of the accompanying Notes to Consolidated Financial Statements for further discussion.

*Insurance recovery from related parties*

In 2006, we recognized a gain of \$3.5 million for insurance proceeds received from Cantor related to the September 11 Events. See Note 3, September 11 Events, of the accompanying Notes to Consolidated Financial Statements for a more detailed discussion of the insurance proceeds received. In 2005, we recognized a gain of \$1.7 million for insurance proceeds received from Cantor related to the September 11 Events.



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### *Grant income*

During the fourth quarter of 2006, we recognized grant income of \$3.1 million related to WTC Business Recovery from Disproportionate Loss Program and the World Trade Center Job Creation and Retention Program as we met all the various thresholds established in the grant agreements.

### *Gain on sale of investments*

During 2005, we sold the secured convertible bond issued by EasyScreen PLC. As a result, we recorded a pre-tax gain of \$1.0 million. There were no gains on sale of investments in 2006.

### *Interest income*

For 2006, the blended weighted average interest rate that we earned on overnight reverse repurchase agreements and money market Treasury funds was 5.2% compared with 3.3% in 2005. As a result of the increase in the weighted average interest rate and average balances between years, we generated interest income of \$9.5 million for 2006 compared with \$6.2 million for 2005, an increase of 54.9%.

## **Revenues Comparison of the years ended December 31, 2005 and 2004**

### *Transaction revenues with related parties*

Total transaction revenues for 2005 were \$102.7 million compared with \$131.0 million in 2004. There were 250 trading days in both years. Volumes transacted on our trading system increased by \$15,947 billion (approximately \$15.9 trillion), or 36.9%, to \$59,178 billion (approximately \$59.2 trillion) for 2005 from \$43,231 billion (approximately \$43.2 trillion) for 2004. During 2005, fully electronic and voice assisted transactions contributed 72.7% and 24.5% of our transaction revenues, respectively, compared with 82.5% and 16.9%, respectively, in 2004.

Fully-electronic transaction revenues with related parties for 2005 were \$74.7 million, a decrease from \$108.0 million in 2004. This decrease was primarily the result of a competitive pricing environment and our customers' transition to fixed fee pricing from a variable fee commission model. Additionally, in January 2005, we removed the Price Improvement feature from our technology platform, which also contributed to the decrease. This decline was partially offset by an increase in U.S. Treasury volume of 11.5%, or \$14.3 trillion, to \$138.7 trillion in 2005 from \$124.4 trillion in 2004 and by growth in our market position.

Voice-assisted brokerage revenues with related parties for 2005 were \$25.2 million, an increase of 13.9% from \$22.1 million in 2004. This increase was primarily due to BGC's investment and expansion in the voice brokerage business, including BGC's acquisition of Maxcor.

Screen-assisted open outcry revenues with related parties for 2005 were \$2.9 million, an increase of 238.4% from \$0.8 million in 2004. The increase was primarily due to BGC's investment and expansion in the voice brokerage business and to BGC's acquisition of Maxcor and ETC Pollak.

### *Software Solutions fees from related parties*

Software Solutions fees from related parties for 2005 were \$24.7 million compared with \$17.4 million in 2004, an increase of 42.0%. This increase resulted from an increase in demand for our support services due to the growth of both the Cantor and BGC businesses.

### *Software Solutions and licensing fees from unrelated parties*

Software Solutions and licensing fees from unrelated parties for 2005 were \$15.5 million compared with \$13.4 million in 2004, a 15.8% increase. This increase was primarily due to incremental revenues generated by our acquisition of ECCO in 2004. Additionally, we earned revenues of approximately \$10.0 million associated with the Wagner Patent during 2005. The Wagner Patent expired on February 20, 2007. See Note 5, Goodwill and Other Intangible Assets, of the accompanying Notes to Consolidated Financial Statements for further discussion.

### *Insurance recovery from related parties*

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In 2005, we recognized a gain of \$1.7 million for insurance proceeds received from Cantor related to the September 11 Events. See Note 3, September 11 Events, of the accompanying Notes to Consolidated Financial Statements for a more detailed discussion of the insurance proceeds received. We had no insurance recovery in 2004.

### *Gain on sale of investments*

During 2005, we sold the secured convertible bond issued by EasyScreen PLC. As a result, we recorded a pre-tax gain of \$1.0 million. There were no gains on sale of investments in 2004.



**Table of Contents***Interest income*

For 2005, the blended weighted average interest rate that we earned on overnight reverse repurchase agreements and money market Treasury funds was 3.3% compared with 1.3% in 2004. As a result of the increase in the weighted average interest rate and average balances between years, we generated interest income of \$6.2 million for 2005 compared with \$3.4 million for 2004, an increase of 78.8%.

**Expenses**

The following table sets forth certain Consolidated Statements of Income data, as restated, expressed as a percentage of total expenses for the periods indicated:

	Year Ended December 31, 2006	Percentage of Total Expenses	Year Ended December 31, 2005  (in thousands)	Percentage of Total Expenses	Year Ended December 31, 2004	Percentage of Total Expenses
Compensation and employee benefits	\$ 52,765	33.6%	\$ 50,633	33.8%	\$ 40,671	32.7%
Amortization of software development costs and other intangible assets, restated	23,811	15.2%	20,093	13.4%	16,310	13.1%
Other occupancy and equipment	37,280	23.7%	30,678	20.5%	25,202	20.3%
Professional and consulting fees	9,464	6.0%	8,788	5.9%	5,594	4.5%
Impairment of long-lived assets	1,861	1.2%	2,386	1.6%	6,268	5.0%
Communications and client networks	8,101	5.2%	8,157	5.4%	6,487	5.2%
Marketing	852	0.5%	1,596	1.1%	1,442	1.2%
Administrative fees to related parties	12,598	8.0%	13,938	9.3%	13,228	10.6%
Amortization of business partner and non-employee securities	19	0.0%	318	0.2%	856	0.7%
Acquisition related costs	2,026	1.3%	3,327	2.2%		
Other	8,289	5.3%	9,896	6.6%	8,219	6.6%
Total operating expenses, restated	\$ 157,066	100.0%	\$ 149,810	100.0%	\$ 124,277	100.0%

**Expenses Comparison of the years ended December 31, 2006 and 2005***Compensation and employee benefits*

Compensation costs for 2006 were \$52.8 million compared with \$50.6 million for 2005. The \$2.2 million or 4.4% increase in compensation costs resulted from higher salaries and benefits. Additionally, with the adoption of SFAS No. 123<sup>®</sup>, Share-Based Payment on January 1, 2006, the Company recognized approximately \$0.6 million of SFAS 123<sup>®</sup> expense in 2006.

Substantially all of our employees are full-time employees located predominately in the New York metropolitan area and London. Compensation costs include salaries, bonuses, stock based compensation, payroll taxes and costs of employer-provided benefits for our employees.

*Amortization of software development costs and other intangibles*

In accordance with the provisions of Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use ( SOP 98-1 ), we capitalize qualifying computer software costs incurred during the application development stage, and amortize them over their estimated useful life which is generally three years on a straight-line basis.

Amortization of software development costs and other intangibles was \$23.8 million for 2006, an increase of \$3.7 million, or 18.4%, compared with \$20.1 million in 2005. This increase was related to accelerated amortization of \$1.2 million due to the anticipated early retirement of certain of our internally developed software which was replaced in the second quarter of 2006, continued investment in software development activities during the prior 12 months and the associated increase in the amortization of software



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development. During the years ended December 31, 2006 and 2005, we recorded Wagner Patent and defense costs amortization of approximately \$4.8 million. With our Wagner Patent having expired on February 20, 2007, our Wagner Patent and defense costs will be fully amortized in the first quarter of 2007.

### *Other occupancy and equipment costs*

Occupancy and equipment costs were \$37.3 million for 2006, a \$6.6 million or 21.5% increase compared with \$30.7 million for 2005. The increase was \$3.8 million in rent primarily attributable to the relocation of our London offices, and \$2.7 million related to increased depreciation and computer expense from IT equipment and fixed asset purchases as we continued to invest in our technical platform to support the growth of our fully-electronic businesses and our affiliated voice brokers.

Occupancy expenditures primarily consisted of the rent and facilities costs of our offices in the New York metropolitan area and London. During the first quarter of 2005, we relocated employees to our new global headquarters at 110 E. 59th Street in New York's midtown Manhattan, and during the first half of 2006, we relocated our London employees to our new offices located in the Canary Wharf section of London. Occupancy and equipment costs may increase in 2007 as we complete work on our global headquarters and our Northeast data center.

### *Professional and consulting fees*

Professional and consulting fees were \$9.5 million for 2006 compared with \$8.8 million for 2005, an increase of \$0.7 million, or 7.7%. This increase was primarily the result of increased technology consulting expenses during the second half of 2006.

### *Impairment of long-lived assets*

Impairment charges were \$1.9 million for 2006 compared with \$2.4 million for 2005, a decrease of \$0.5 million, or 20.8%. In 2006 and 2005, we incurred impairment charges primarily related to discarded software development and fixed assets no longer in service. For further discussion, see Note 4, Fixed Assets, and Note 5, Goodwill and Other Intangible Assets, of the accompanying Notes to Consolidated Financial Statements.

### *Communications and client networks*

Communications costs were \$8.1 million for 2006 compared with \$8.2 million in 2005. We anticipate expenditures for communications and client networks may increase in the future as we continue to connect additional customers to our network.

### *Marketing*

Marketing expense in 2006 was \$0.9 million compared with \$1.6 million in 2005. The decrease of \$0.7 million is a result of a decrease in marketing campaigns during 2006.

### *Administrative fees to related parties*

Under The Administrative Services Agreement, Cantor provides various administrative services to us, including accounting, tax, legal, human resources and facilities management, for which we reimburse Cantor for the direct and indirect costs of providing such services. Administrative fees to related parties are dependent upon both the costs incurred by Cantor and the portion of Cantor's administrative services that is utilized by us. Administrative fees to related parties amounted to \$12.6 million for 2006, a decrease of \$1.3 million, or 9.4%, compared with \$13.9 million in 2005.

### *Amortization of business partner and non-employee securities*

We enter into strategic alliances with other industry participants in order to expand our business and to enter into new marketplaces. As part of these strategic alliances, we have issued warrants and convertible preferred stock. These securities do not require cash outlays and do not represent a use of our assets. The expense related to these issuances is based on the value of the securities being issued and the structure of the transaction. Generally, this expense is amortized over the term of the related agreement.

Charges in relation to the amortization of business partner and non-employee securities were \$19,000 for 2006 compared with \$0.3 million in 2005. The decrease resulted from non-employee options that became fully amortized at the end of the first quarter of 2006.



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### *Acquisition- related costs*

During 2006, we recorded \$2.0 million of acquisition-related costs with respect to a potential acquisition that we determined not to pursue further at that time. During the comparable period in 2005, we recorded \$3.3 million of acquisition-related costs. These costs primarily included legal, advisory and other related expenses.

### *Other expenses*

Other expenses consist primarily of insurance costs, travel, promotional and entertainment expenditures. For 2006, other expenses were \$8.3 million, a decrease of \$1.6 million, or 16.2%, compared with other expenses of \$9.9 million for the comparable period in 2005. This decrease was principally due to lower travel and entertainment related expenses and a collection of a fully reserved receivable of \$0.7 million related to a legal settlement with Municipal Partners.

### *Income taxes*

During 2006, we recorded an income tax provision of \$3.0 million corresponding to a 38.9% effective tax rate, compared with an income tax provision of \$0.4 million corresponding to a 24.2% effective tax rate in 2005. Our consolidated effective tax rate can vary from period to period depending on, among other factors, permanent differences and the geographic and business mix of our earnings.

## **Expenses Comparison of the years ended December 31, 2005 and 2004**

### *Compensation and employee benefits*

Compensation costs for 2005 were \$50.6 million compared with \$40.7 million for 2004. The \$9.9 million or 24.3% increase in compensation costs resulted from additional salaries and benefits associated with the hiring of new technology and sales personnel, the full year impact of our senior management hires and of our ECCO acquisition and a transition from a stock option-based to a restricted stock based compensation model.

Substantially all of our employees are full-time employees located predominately in the New York metropolitan area and London. Compensation costs include salaries, bonuses, payroll taxes and costs of employer-provided benefits for our employees.

### *Amortization of software development costs and other intangibles*

In accordance with the provisions of Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, ( SOP 98-1 ), we capitalize qualifying computer software costs incurred during the application development stage, and amortize them over their estimated useful life which is generally three years on a straight-line basis. Amortization of software development costs and other intangibles was \$20.1 million for 2005, an increase of \$3.8 million, or 23.3%, compared with \$16.3 million in 2004. This increase was primarily related to increased investment in software development activities as we continued to devote significant resources to the innovation and development of technology and protection of our intellectual property portfolio. In addition, the full-year impact from amortization of purchased intangible assets from our ECCO acquisition contributed to the increase. Additionally, during the years ended December 31, 2005 and 2004, we recorded Wagner Patent and defense costs amortization of approximately \$4.8 million.

### *Other occupancy and equipment cost*

Occupancy and equipment costs were \$30.7 million for 2005, a \$5.5 million or 21.7% increase compared with \$25.2 million for 2004. This increase was primarily attributable to additional depreciation expense associated with IT equipment purchases and relocation to our permanent corporate headquarters in New York City.

Occupancy expenditures primarily consisted of the rent and facilities costs of our offices in the New York metropolitan area and our offices in London and Tokyo. During the first quarter of 2005, we relocated employees to our new global headquarters at 110 E. 59<sup>th</sup> Street in New York s midtown Manhattan.

### *Professional and consulting fees*

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Professional and consulting fees were \$8.8 million for 2005 compared with \$5.6 million for 2004, an increase of \$3.2 million, or 57.1%. This increase was primarily the result of legal expenses incurred in connection with patent litigation defense costs.

### *Impairment of long-lived assets*

Impairment charges were \$2.4 million for 2005 compared with \$6.3 million for 2004, a decrease of \$3.9 million, or 61.9%. In 2004, impairment charges were recorded for capitalized costs related to our 580 Patent and removal of the PI software feature. In 2005, we incurred impairment charges for discarded software development and fixed assets no longer in service. For further discussion, see Note 4, Fixed Assets, and Note 5, Goodwill and Other Intangible Assets, of the accompanying Notes to Consolidated Financial Statements.

**Table of Contents***Communications and client networks*

Communications costs were \$8.2 million for 2005 compared with \$6.5 million in 2004, an increase of \$1.7 million, or 25.7%. This increase was primarily due to duplicate communication costs incurred at our temporary and permanent headquarters, and upgraded communications costs at our permanent headquarters. Also in 2005, we incurred additional costs related to the opening of our Chicago data center and our roll-out of a wireless government bond trading solution that allows clients to trade through an eSpeed application on Blackberry devices.

*Administrative fees to related parties*

Under The Administrative Services Agreement, Cantor provides various administrative services to us, including accounting, tax, legal, human resources and facilities management, for which we reimburse Cantor for the direct and indirect costs of providing such services. Administrative fees to related parties are dependent upon both the costs incurred by Cantor and the portion of Cantor's administrative services that is utilized by us. Administrative fees to related parties amounted to \$13.9 million for 2005, an increase of \$0.7 million, or 5.4%, compared with \$13.2 million in 2004.

*Amortization of business partner and non-employee securities*

We enter into strategic alliances with other industry participants in order to expand our business and to enter into new marketplaces. As part of these strategic alliances, we have issued warrants and convertible preferred stock. These securities do not require cash outlays and do not represent a use of our assets. The expense related to these issuances is based on the value of the securities being issued and the structure of the transaction. Generally, this expense is amortized over the term of the related agreement.

Charges in relation to the amortization of business partner and non-employee securities were \$0.3 million for 2005 compared with \$0.9 million in 2004. This \$0.6 million decrease resulted primarily from a warrant agreement that became fully amortized at the end of the first quarter of 2004, and thus contributed no amortization expense during 2005.

*Acquisition- related costs*

During 2005, we recorded \$3.3 million of acquisition related costs in connection with our MTS offer. These costs primarily included legal, accounting, advisory and other related expenses. There were no acquisition related costs in 2004.

*Other expenses*

Other expenses consist primarily of insurance costs, travel, promotional and entertainment expenditures. For 2005, other expenses were \$9.9 million, an increase of \$1.7 million, or 20.4%, compared with other expenses of \$8.2 million for 2004. This increase was principally due to employee recruiting costs, moving expenses related to our new office and travel and entertainment-related expenses.

*Income taxes*

During 2005, we recorded an income tax provision of \$0.5 million corresponding to a 24.2% effective tax rate compared with an income tax provision of \$16.0 million corresponding to a 39.1% effective tax rate in 2004. Our consolidated effective tax rate can vary from period to period depending on, among other factors, permanent differences and the geographic and business mix of our earnings.

**Market Summary**

The following table provides certain volume and transaction count information on the eSpeed system for the periods indicated:

	Quarterly Market Activity for the Quarters Ended		Yearly Market Activity for the Years Ended	
	December 31, 2006	December 31, 2005	December 31, 2006	December 31, 2005
<b>Volume (in billions)</b>				
Fully Electronic Volume - Excluding New Products	\$ 9,813	\$ 7,500	\$ 38,385	\$ 29,009

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Fully Electronic Volume - New Products	1,335	539	3,783	1,858
Total Fully Electronic Volume	11,148	8,039	42,168	30,867
Voice Assisted Volume	7,933	7,608	32,860	28,311
Screen Assisted Volume	6,111	4,155	22,887	10,366
Total Volume	\$ 25,192	\$ 19,802	\$ 97,915	\$ 69,544

**Transaction Count (in billions)**

Fully Electronic Transactions - Excluding New Products	1,764,930	1,640,167	7,459,514	5,642,628
Fully Electronic Transactions - New Products	142,239	111,801	552,899	390,001
Total Fully Electronic Transactions	1,907,169	1,751,968	8,012,413	6,032,629
Voice Assisted Transactions	177,789	193,742	792,159	822,391
Screen Assisted Transactions	62,977	46,242	268,894	112,123

Total Transactions	2,147,935	1,991,952	9,073,466	6,967,143
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eSpeed Equities Direct Access (Number of Shares Traded In Millions)	184	147	770	648
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Trading Days	62	61	250	250
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**U.S. Primary Dealer Treasury Volume (in billions)**

U.S. Treasury Volume	\$ 30,742	\$ 32,820	\$ 131,410	\$ 138,694
Average Daily U.S. Treasury Volume	\$ 496	\$ 538	\$ 526	\$ 555



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Reported volumes and transaction counts include transactions by Cantor and its affiliates that participate in certain of our marketplaces by posting quotations for their accounts and by acting as principal on trades. While the principal participation may vary widely from product to product and may be significant for any given product or period, in no case does the principal participation by Cantor and its affiliates exceed 10% of any of the reported volume or transaction counts, except as otherwise noted. Such activity is intended, among other things, to assist these affiliates in managing their proprietary positions, and to facilitate transactions, add liquidity, increase commissions and attract additional order flow to the eSpeed system and revenue to both us and Cantor and its affiliates.

### ***Quarterly Market Activity***

Fully electronic volume on our system, excluding new products, was \$9.8 trillion for the quarter ended December 31, 2006, up 30.8% from \$7.5 trillion for the quarter ended December 31, 2005. Our combined voice-assisted and screen-assisted volume for the quarter ended December 31, 2006 was \$14.0 trillion, an increase of 19.4% from \$11.8 trillion for the quarter ended December 31, 2005.

Fully electronic volume on our system for new products, which we define as foreign exchange, interest rate swaps, futures and repos, was \$1.3 trillion for the quarter ended December 31, 2006, up 147.7% against the \$0.5 trillion for the quarter ended December 31, 2005.

### ***Yearly Market Activity***

Fully electronic volume on our system, excluding new products, was \$38.4 trillion for the year ended December 31, 2006, up 32.3 percent from \$29.0 trillion for the year ended December 31, 2005. Our combined voice-assisted and screen-assisted volume for the year ended December 31, 2006 was \$55.7 trillion, an increase of 44.1% from \$38.7 trillion for the year ended December 31, 2005.

Fully electronic volume on our system for new products was \$3.8 trillion for year ended December 31, 2006, up 103.6% against the \$1.9 trillion for the year ended December 31, 2005.

## **SEASONALITY**

The financial markets in which we operate are generally affected by seasonality. Traditionally, the financial markets around the world experience lower volume during the summer and at the end of the year due to a general slowdown in the business environment and, therefore, transaction volume levels may decrease during those periods. The timing of the holidays generally contributes to a slowdown in transaction volume.

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**LIQUIDITY AND CAPITAL RESOURCES**

Our principal source of liquidity is our operating cash flow and strong balance sheet. This cash-generating capability is one of our fundamental strengths and provides us with substantial financial flexibility in meeting operating, investing and financing needs. At December 31, 2006, we had cash and cash equivalents of \$187.8 million, an increase of \$9.4 million, or 5.3%, compared with \$178.4 million at December 31, 2005.

***Operating Activities***

Our operating cash flows consist of transaction revenues and Software Solutions fees from related and unrelated parties, various fees paid to or costs reimbursed to Cantor, other costs paid directly by us and interest income. During 2006, our operating activities provided cash of \$36.8 million compared with \$27.7 million in 2005. For the year ended December 31, 2006 as compared with the year ended December 31, 2005, net income increased approximately \$3.1 million. For the year ended December 31, 2006 as compared with the year ended December 31, 2005, depreciation and amortization expense increased \$5.4 million due to an increase in the underlying fixed asset base. The \$3.5 million insurance recovery included in net income for the year ended December 31, 2006 is presented as part of investing activities in the Statement of Cash Flows as the proceeds will be used to purchase fixed assets. During 2005, we had a gain on sale of an investment of \$1.0 million, and no gain or loss on sales of investments during 2006. The change in other assets for the year ended December 31, 2006 as compared with the year ended December 31, 2005 was \$5.1 million primarily due to increased receivables related to the licensing of the Wagner Patent which were pre-paid in the prior year. The \$6.1 million change in accounts payable and accrued expenses for the year ended December 31, 2006 as compared with the year ended December 31, 2005 was primarily due to deferred income recognized in 2005 and the timing of payments to vendors in 2006. The change in deferred income of \$3.4 million from the year ended December 31, 2006 as compared with the year ended December 31, 2005 was a result of recognizing income related to the WTC Business Recovery from Disproportionate Loss Program and the World Trade Center Job Creation and Retention Program during the fourth quarter of 2006.

In its capacity as a fulfillment service provider, Cantor processes and settles transactions and, as such, collects and pays the funds necessary to clear transactions with the counterparty. In doing so, Cantor receives our portion of the transaction fee and, in accordance with the Joint Services Agreement, remits the amount owed to us. In addition, we have entered into similar services agreements with BGC, Freedom, and CO2e. Under the Administrative Services Agreement, the JSA and the services agreements with BGC, Freedom and CO2e, any net receivable or payable is settled monthly.

***Investing Activities***

During 2006, we used cash in investing activities of \$28.2 million compared with \$30.2 million in 2005. The decrease was due to the receipt of \$3.5 million in insurance proceeds related to the replacement of fixed assets lost in the September 11 Events (see Note 3, September 11 Events, of the accompanying Notes to Consolidated Financial Statements for more information regarding the September 11 Events), decreased purchases of fixed assets and lower capitalized software development costs and patent defense costs during 2006 as compared with 2005, offset by the \$5.8 million received in 2005 for the sale of the Easyscreen bond.

***Financing Activities***

During 2006, our financing activities provided cash of \$0.8 million compared with cash used for financing activities of \$28.7 million in 2005. During 2006, we repurchased less shares of our Class A common stock under our repurchase plan approved by our Board of Directors as compared with the approximate 3.5 million shares of our Class A common stock for a total of \$29.2 million that we repurchased during 2005. Our Board of Directors has authorized the repurchase of up to an additional \$100 million of our outstanding Class A common stock, of which \$58.2 million remained available for repurchase as of December 31, 2006. In the future, we may continue to repurchase shares opportunistically. In addition, proceeds from exercises of employee stock options were higher in 2006, which was partially offset by withholding tax requirements related to the vesting of restricted stock units.

We anticipate, based on management's experience and current industry trends, that our existing cash resources will be sufficient to meet our anticipated working capital and capital expenditure requirements for at least the next 12 months. However, we believe that there are a significant number of capital intensive opportunities for us to maximize our growth and strategic position, including, among other things, acquisitions, strategic alliances and joint ventures potentially involving all types and combinations of equity, debt, acquisition, recapitalization and reorganization alternatives. As a result, we may need to raise additional funds to:

increase the regulatory net capital necessary to support our operations;

support more rapid growth in our business;

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develop new or enhanced services and products;

respond to competitive pressures;

acquire complementary technologies and businesses; and

respond to unanticipated requirements.

We cannot assure you that we will be able to obtain additional financing when needed on terms that are acceptable, if at all. We are continually considering such options, including the possibility of additional repurchases of our Class A common stock, and their effect on our liquidity and capital resources.

**AGGREGATE CONTRACTUAL OBLIGATIONS**

As of December 31, 2006, our significant contractual obligations amounted to \$76.0 million, consisting of the following payments:

<b>Contractual Obligations</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>2011</b>	<b>2012 and thereafter</b>
Leases <sup>(1)</sup>	\$ 3,936	\$ 3,589	\$ 3,589	\$ 3,720	\$ 4,170	\$ 32,913
Purchase Obligations <sup>(2)</sup>	24,088					