

CHICAGO MERCANTILE EXCHANGE HOLDINGS INC  
Form 10-Q/A  
September 26, 2002

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q/A  
Amendment No. 1**

(Mark One)

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

For the quarterly period ended March 31, 2002

-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 000-33379

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**CHICAGO MERCANTILE EXCHANGE HOLDINGS INC.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**36-4459170**

(I.R.S. Employer  
Identification Number)

**30 South Wacker Drive, Chicago, Illinois**

(Address of principal executive offices)

**60606**

(Zip Code)

**(312) 930-1000**

(Registrant's telephone number, including area code)

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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

The number of shares outstanding of each of the registrant's classes of common stock as of April 30, 2002 was as follows: 7,222,776 shares of Class A common stock, Class A-1, \$0.01 par value; 7,222,776 shares of Class A common stock, Class A-2, \$0.01 par value; 7,222,574 shares of Class A common stock, Class A-3, \$0.01 par value; 7,219,436 shares of Class A common stock, Class A-4, \$0.01 par value; 625 shares of Class B common stock, Series B-1, \$0.01 par value; 813 shares of Class B common stock, Series B-2, \$0.01 par value; 1,287 shares of Class B common stock, Series B-3, \$0.01 par value; and 413 shares of Class B common stock, Series B-4, \$0.01 par value.

EXPLANATORY NOTE: Pursuant to Rule 12b-15 of the Securities Exchange Act of 1934, as amended, Chicago Mercantile Exchange Holdings Inc. (the "Company") hereby amends its Quarterly Report of Form 10-Q for the quarterly period ended March 31, 2002 (the "Quarterly Report"), filed with the Securities and Exchange Commission on May 8, 2002, to restate the Company's Unaudited Consolidated Financial Statements for the quarter ended March 31, 2002 included in the Quarterly Report and to revise the related disclosures. The restatement relates to a change in the accounting for the stock option granted to the Company's Chief Executive Officer. For further information regarding the restatement, see Note 2, "Restatement," to the Company's Unaudited Consolidated Financial Statements for the quarter ended March 31, 2002.

**CHICAGO MERCANTILE EXCHANGE HOLDINGS INC.  
FORM 10-Q/A  
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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except share data)  
(unaudited and restated)**

	<u>MARCH 31, 2002</u>	<u>DECEMBER 31, 2001</u>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 65,902	\$ 69,101

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	MARCH 31, 2002	DECEMBER 31, 2001
	<u>                    </u>	<u>                    </u>
Proceeds from securities lending activities	740,312	882,555
Marketable securities	96,767	91,570
Accounts receivable, net of allowance of \$737 and \$962	43,395	40,986
Other current assets	6,559	6,671
Cash performance bonds and security deposits	1,005,459	855,227
	<u>                    </u>	<u>                    </u>
Total current assets	1,958,394	1,946,110
Property, net of accumulated depreciation and amortization	102,987	100,991
Other assets	24,946	21,780
	<u>                    </u>	<u>                    </u>
<b>TOTAL ASSETS</b>	<b>\$ 2,086,327</b>	<b>\$ 2,068,881</b>
	<u>                    </u>	<u>                    </u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 16,022	\$ 23,834
Payable under securities lending agreements	740,312	882,555
Other current liabilities	40,541	40,229
Cash performance bonds and security deposits	1,005,459	855,227
	<u>                    </u>	<u>                    </u>
Total current liabilities	1,802,334	1,801,845
Long-term debt	5,741	6,650
Other liabilities	10,735	10,017
	<u>                    </u>	<u>                    </u>
Total liabilities	1,818,810	1,818,512
	<u>                    </u>	<u>                    </u>
Shareholders' Equity:		
Preferred stock, \$0.01 par value, 9,860,000 shares authorized, none issued and outstanding		
Series A junior participating preferred stock, \$0.01 par value, 140,000 shares authorized, none issued and outstanding		
Class A common stock, \$0.01 par value, 138,000,000 shares authorized, 28,771,562 shares issued and outstanding	288	288
Class B common stock, \$0.01 par value, 3,138 shares authorized, issued and outstanding		
Additional paid-in capital	57,901	63,451
Unearned restricted stock compensation	(1,102)	(1,461)
Retained earnings	210,536	187,814
Accumulated net unrealized gains (losses) on securities	(106)	277
	<u>                    </u>	<u>                    </u>
Total shareholders' equity	267,517	250,369
	<u>                    </u>	<u>                    </u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 2,086,327</b>	<b>\$ 2,068,881</b>
	<u>                    </u>	<u>                    </u>

See accompanying notes to financial statements.

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(in thousands, except share and per share data)  
(unaudited and restated)

	FOR THE THREE MONTHS ENDED MARCH 31,	
	2002	2001
<b>REVENUES</b>		
Clearing and transaction fees	\$ 77,885	\$ 70,938
Quotation data fees	12,465	10,225
GLOBEX access fees	3,130	2,347
Communication fees	2,405	2,256
Investment income	1,617	2,573
Securities lending interest income	3,514	
Other	3,053	3,831
<b>TOTAL REVENUES</b>	<b>104,069</b>	<b>92,170</b>
Securities lending interest expense	(2,977)	
<b>NET REVENUES</b>	<b>101,092</b>	<b>92,170</b>
<b>EXPENSES</b>		
Salaries and benefits	29,227	25,059
Stock-based compensation	(5,191)	3,473
Occupancy	5,781	5,257
Professional fees, outside services and licenses	7,261	6,018
Communications and computer and software maintenance	10,308	9,988
Depreciation and amortization	10,814	8,888
Public relations and promotion	1,563	581
Other	3,429	2,990
<b>TOTAL EXPENSES</b>	<b>63,192</b>	<b>62,254</b>
Income before income taxes	37,900	29,916
Income tax provision	(15,178)	(11,975)
<b>NET INCOME</b>	<b>\$ 22,722</b>	<b>\$ 17,941</b>
<b>EARNINGS PER SHARE:</b>		
Basic	\$ 0.79	\$ 0.62
Diluted	\$ 0.76	\$ 0.62
Weighted average number of common shares:		
Basic	28,774,700	28,774,700
Diluted	29,907,219	28,860,955

See accompanying notes to financial statements.

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
(dollars in thousands, except share data)  
(unaudited and restated)

	Class A Common Stock	Class B Common Stock	Common Stock and Additional Paid-in Capital	Unearned Restricted Stock Compensation	Retained Earnings	Accumulated Net Unrealized Securities Gains (Losses)	Total Shareholders' Equity
	Shares	Shares	Amount				
BALANCE, DECEMBER 31, 2001	28,771,562	3,138	\$ 63,739	\$ (1,461)	\$ 187,814	\$ 277	\$ 250,369
Comprehensive income:							
Net income					22,722		22,722
Change in net unrealized loss on securities, net of tax benefit of \$255						(383)	(383)
Total comprehensive income							22,339
Stock-based compensation			(5,550)				(5,550)
Amortization of unearned restricted stock compensation				359			359
BALANCE, MARCH 31, 2002	28,771,562	3,138	\$ 58,189	\$ (1,102)	\$ 210,536	\$ (106)	\$ 267,517
BALANCE, DECEMBER 31, 2000	28,771,562	3,138	\$ 44,170		\$ 119,512	\$ (11)	\$ 163,671
Comprehensive income:							
Net income					17,941		17,941
Change in net unrealized gain on securities, net of tax of \$144						214	214
Total comprehensive income							18,155
Stock-based compensation			3,473				3,473
BALANCE, MARCH 31, 2001	28,771,562	3,138	\$ 47,643		\$ 137,453	\$ 203	\$ 185,299

See accompanying notes to financial statements.

**CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands)  
(unaudited and restated)

**THREE MONTHS ENDED  
MARCH 31,**

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	THREE MONTHS ENDED MARCH 31,	
	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net income	\$ 22,722	\$ 17,941
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on investment in joint venture	520	
Deferred income tax provision (benefit)	509	(1,465)
Stock-based compensation	(5,191)	3,473
Depreciation and amortization	10,814	8,888
Gain on sale of marketable securities	(48)	(70)
Increase (decrease) in allowance for doubtful accounts	(225)	1,883
Increase in accounts receivable	(2,184)	(14,325)
Decrease (increase) in other current assets	112	(522)
Decrease (increase) in other assets	(1,133)	55
Increase (decrease) in accounts payable	(7,812)	6,007
Increase in other current liabilities	182	2,746
Increase (decrease) in other liabilities	718	(511)
	<u>18,984</u>	<u>24,100</u>
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>18,984</b>	<b>24,100</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchases of property, net	(11,987)	(10,483)
Purchases of marketable securities	(29,807)	(30,826)
Proceeds from sales and maturities of investments	24,019	20,139
Additional investment in joint venture	(3,071)	
	<u>(20,846)</u>	<u>(21,170)</u>
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(20,846)</b>	<b>(21,170)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Payments on long-term debt	(1,337)	(961)
	<u>(1,337)</u>	<u>(961)</u>
<b>NET CASH USED IN FINANCING ACTIVITIES</b>	<b>(1,337)</b>	<b>(961)</b>
Net increase (decrease) in cash and cash equivalents	(3,199)	1,969
Cash and cash equivalents, beginning of period	69,101	30,655
	<u>65,902</u>	<u>32,624</u>
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	<b>\$ 65,902</b>	<b>\$ 32,624</b>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>		
Interest paid	\$ 124	\$ 227
	<u>2,440</u>	<u>15</u>
Income taxes paid	\$ 2,440	\$ 15
	<u>558</u>	<u></u>
Leased asset additions and related obligations	\$ 558	\$

See accompanying notes to financial statements

**CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**1. BASIS OF PRESENTATION**

The accompanying interim financial statements have been prepared by Chicago Mercantile Exchange Holdings Inc. (CME Holdings) without audit. Certain notes and other information normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted. In the opinion of management, the accompanying consolidated financial statements include all adjustments necessary to present fairly the financial position of CME Holdings as of March 31, 2002 and December 31, 2001, and the results of its operations and cash flows for the periods indicated.

On December 3, 2001, the reorganization of Chicago Mercantile Exchange Inc. (CME) into a holding company structure was completed. The reorganization was completed by merging CME into a wholly owned subsidiary of a newly formed holding company, Chicago Mercantile Exchange Holdings Inc. In the merger, CME shareholders exchanged their equity interests in CME for similar equity interests in CME Holdings. Prior to the reorganization, CME Holdings had no significant assets or liabilities. These financial statements have been prepared as if the holding company structure had been in place for all periods presented.

The accompanying financial statements should be read in connection with the financial statements and notes thereto in Item 8 of the Chicago Mercantile Exchange Holdings Inc. Annual Report on Form 10-K/A for the year ended December 31, 2001 and with Note 2 included in this filing. Quarterly results are not necessarily indicative of results for any subsequent period.

Certain reclassifications have been made to the 2001 financial statements to conform to the presentation in 2002.

**2. RESTATEMENT**

CME Holdings has restated the consolidated financial statements for the quarters ended March 31, 2002 and 2001. This Form 10-Q/A includes all adjustments relating to the restatement for all such periods. The restatement relates to a change in the accounting for the stock option granted to the company's Chief Executive Officer. On November 13, 2000, the date of demutualization, the company elected to account for all stock options in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. In consultation with the company's prior auditors, Arthur Andersen LLP, fixed accounting treatment was adopted on the date of demutualization for the Class A shares included in this option. During the second quarter of 2001, variable accounting was adopted for the Class B shares included in this option. CME Holdings' current auditors, Ernst & Young LLP, have advised that, in their view, variable accounting was appropriate for the entire option since the date of demutualization. This conclusion was reached based on the view that one accounting treatment is required for all classes of stock included in this option and that, as a result of certain stipulations within the option agreement, variable accounting treatment is required. Management has accepted this conclusion, and adopted the change.

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As a result of the restatement, the impact on net income and earnings per share is as follows for the periods presented (in thousands):

	Three Months Ended	
	March 31, 2002	March 31, 2001
Net income, as reported	\$ 17,109	\$ 19,990
Decrease (increase) in stock-based compensation expense	9,310	(3,431)
Tax effect	(3,697)	1,382
Net income, as restated	\$ 22,722	\$ 17,941
Earnings per share, as reported:		
Basic	\$ 0.59	\$ 0.69
Diluted	\$ 0.57	\$ 0.69

Three Months Ended

Earnings per share, as restated:

Basic	\$	0.79	\$	0.62
Diluted	\$	0.76	\$	0.62

This change has no impact on CME Holdings' previously reported cash flows and no material balance sheet impact.

### 3. PERFORMANCE BONDS AND SECURITY DEPOSITS

Each firm that clears futures and options on futures contracts traded on the exchange is required to deposit and maintain specified performance bonds in the form of cash, U.S. Government securities or bank letters of credit. These performance bonds are available only to meet the financial obligations of that clearing firm to the exchange. Cash performance bonds and security deposits may fluctuate due to the investment choices available to clearing firms and the change in the amount of deposits required. As a result, these assets may vary significantly over time. See Note 6 of Notes to Consolidated Financial Statements in Item 8 to the CME Holdings Annual Report on Form 10-K/A for the year ended December 31, 2001.

### 4. INVESTMENT IN JOINT VENTURE

On August 28, 2001, CME entered into a joint venture, OneChicago, LLC, with the Chicago Board Options Exchange and the Chicago Board of Trade, to trade single-stock futures and narrow-based stock indexes. In February 2001, CME contributed an additional \$3.1 million of capital. At March 31, 2002, CME owned a 42% interest in the joint venture, and the investment is reflected in the financial statements using the equity method of accounting. The investment balance at March 31, 2002 represents CME's total capital contribution of \$4.4 million reduced by its proportionate share of the joint venture's net loss. The net loss is included in other operating revenue and totaled \$0.5 million for the three months ended March 31, 2002.

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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Corporate Structure

We are the largest futures exchange in the United States, as measured by 2001 annual trading volume. Our international marketplace brings together buyers and sellers on our trading floors, as well as through our GLOBEX electronic trading platform and privately negotiated transactions. We offer market participants the opportunity to trade futures contracts and options on futures primarily in four product areas: interest rates, stock indexes, foreign exchange and commodities.

Our exchange was organized in 1898 as a not-for-profit membership organization. Until recently, our business strategy and fee structure were designed to provide profit opportunities for our members. On November 13, 2000, we became the first U.S. financial exchange to become a for-profit corporation by converting membership interests into shares of common stock.

On December 3, 2001, we completed our reorganization of Chicago Mercantile Exchange Inc. (CME) into a holding company structure. The reorganization was completed by merging CME into a wholly owned subsidiary of a newly formed holding company, Chicago Mercantile Exchange Holdings Inc. (CME Holdings). In the merger, CME shareholders exchanged their equity interests in CME for similar equity interests in CME Holdings. Prior to the reorganization, CME Holdings had no significant assets or liabilities. Our financial statements have been prepared as if the holding company structure had been in place for all periods presented.

### Revenues

Our revenues consist of clearing and transaction fees; quotation data fees; GLOBEX access fees; communication fees; investment income, including securities lending activities; and other operating revenue. The revenues derived from clearing and transaction fees, which represent 77.0% of net revenues for the three months ended March 31, 2002, are determined by three factors: volume, rates and the mix of trades.



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Our clearing and transaction fee revenues are tied directly to volume and underlying market uncertainty. We attempt to mitigate the downside of unpredictable volume swings through various means, such as increasing clearing fees, creating volume incentives, opening access to new markets and further diversifying the range of products and services we offer.

Similar to volume, the rate structure for clearing and transaction fees has a significant impact on revenue. We implemented rate increases in the fourth quarter of 2000 and first quarter of 2001 which have had a positive impact on our revenues. The pricing changes in the first quarter of 2001 retained some of the increases from the fourth quarter of 2000; implemented charges for some services previously provided at no charge, such as order routing; altered the pricing structure for access to GLOBEX; and reduced certain fees to stimulate activity in targeted areas.

The mix of trades reflects the types of products traded, the method by which trades are executed and the percentage of transactions executed by members compared to non-members. All transactions are charged a clearing fee that differs by type of contract traded. Additional fees from trades executed through GLOBEX and privately negotiated transactions have become an increasing source of revenue, as the percentage of trades executed electronically and the volume of privately negotiated transactions have increased. Finally, the percentage of trades attributed to non-members impacts revenue, as higher fees are charged to non-member customers than to members.

Our transaction fee revenues, stated as an average rate per contract, are illustrated in the table below (in thousands, except per contract amounts):

	Year Ended December 31,					Three Months Ended March 31,	
	1997	1998	1999	2000	2001	2001	2002
Transaction Revenues	\$ 116,917	\$ 126,524	\$ 140,305	\$ 156,649	\$ 292,459	\$ 70,938	\$ 77,885
Total Contracts Traded	200,742	226,619	200,737	231,110	411,712	92,714	120,520
Average Rate per Contract	\$ 0.582	\$ 0.558	\$ 0.699	\$ 0.678	\$ 0.710	\$ 0.765	\$ 0.646

The trend in the average rate per contract is influenced by a variety of factors. As the percentage of trades executed electronically has grown, the average rate per contract has increased from 1997 to 2001. The average rate

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per contract decreased in 1998 as a result of fee reductions and rebates. The decline in the average rate per contract from 1999 to 2000 resulted primarily from two factors: a larger percentage of trades were executed by members, who are charged lower rates; and there was a decline in demand for some of our product delivery services. The increase in 2001 reflects increases in pricing that were partially offset by a shift in the type of products traded. The decrease in the average rate per contract from the first quarter of 2001 to the first quarter of 2002 was primarily the result of a decrease in the percentage of trades attributed to non-members, volume discounts on certain products and limits on some fees associated with trading through the GLOBEX platform. Volume discounts that were implemented in the first quarter of 2001 as part of our pricing changes were expanded in the third quarter of 2001, resulting in a decrease in our average rate per contract since that time. In addition, a growing percentage of our trading volume is derived from GLOBEX. As a result of the limits on certain GLOBEX fees, the additional trading volume generated through GLOBEX has generated additional clearing fees, but has not necessarily resulted in additional GLOBEX fees.

Transaction fees are calculated and recorded as revenue when the trade is accepted and processed through our Clearing House. The amount of the fee is affected by several factors. Should any of these factors, such as the membership status of the individual making the trade, require correction in our fee system, a fee adjustment can be processed for a period of three months following the month in which the trade occurred. Based on historical trends, we have established a reserve to allow for the likelihood of future adjustments to fees that have already been recorded as revenue and collected from clearing firms.

Our second largest source of revenue is quotation data fees, which we receive from the sale of our market data. At year-end 2001, more than 48,000 subscribers displayed our data on approximately 190,000 screens worldwide. The pricing of quotation data services was increased on March 1, 2001 as part of the pricing changes implemented in 2001. We began to offer E-quotes, an additional market data service utilizing Internet access, in March 2002.

GLOBEX access fees are the connectivity charges to customers of our electronic trading platform. The fee each customer is charged varies depending on the type of connection provided. There is a corresponding communication expense associated with providing these connections that varies based on the type of connection selected by the customer.

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Communication fees consist of charges to members and firms that utilize our various telecommunications networks and communications services. Revenue from communication fees is dependent on open outcry trading, as a significant portion relates to telecommunications on the trading floor. There is a corresponding variable expense associated with providing these services.

Investment income represents earnings from our general investment portfolio, as well as income generated by the short-term investment of clearing firms' cash performance bonds and security deposits. Investment income is influenced by our operating results, market interest rates and changes in the levels of cash performance bonds deposited by clearing firms. The total cash performance bonds deposited by clearing firms is a function of the type of collateral used to meet performance bond requirements, the number of open positions held by clearing firms and volatility in our markets. As a result, the amount of cash deposited by clearing firms is subject to significant fluctuation. For example, cash performance bonds and security deposits totaled \$855.2 million at December 31, 2001, compared to \$1.0 billion at March 31, 2002.

Beginning late in the second quarter of 2001, we entered into securities lending transactions utilizing a portion of the securities that clearing firms deposited to satisfy their proprietary performance bond requirements. Securities lending interest income is presented separately in the consolidated statements of income. Substantial interest expense is incurred as part of this securities lending activity and is presented as a deduction from total revenues to arrive at net revenues.

Other revenue is composed of fees for trade order routing and various services to members, as well as fees for administering our Interest Earning Facilities. We offer clearing firms the opportunity to invest cash performance bonds in an Interest Earning Facility (IEF®). These clearing firms receive interest income, and we receive a fee based on total funds on deposit. Other revenue also includes trading revenue generated by GFX Corporation (GFX), our wholly owned subsidiary that trades in foreign exchange futures contracts to enhance liquidity in our markets for these products. In 2001, we entered into a joint venture, OneChicago, LLC, to trade single stock futures. We have a 42% ownership interest in the joint venture as of March 31, 2002. Our share of the net loss from this joint venture is included in other revenue.

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A substantial portion of our clearing and transaction fees, telecommunications fees and various service charges included in other revenue are billed to the clearing firms of the exchange. The majority of clearing and transaction fees received from clearing firms represent charges for trades executed on behalf of the customers of the various clearing firms. There are currently approximately 70 clearing firms and one firm does represent more than 10% of our revenue. Should a clearing firm withdraw from CME, we believe the customer portion of that firm's trading activity would most likely transfer to another clearing firm. Therefore, we do not believe that the exchange is exposed to significant risk from the loss of revenue received from any particular clearing firm.

### **Expenses**

Salaries and benefits expense is our most significant expense and includes employee wages, bonuses, related benefits and employer taxes. Changes in this expense are driven by increases in wages as a result of inflation or labor market conditions, the number of employees, rates for employer taxes and price increases affecting benefits. Annual bonus payments also vary from year to year and have a significant impact on total salaries and benefits expense.

Stock-based compensation is the expense for stock options and restricted stock grants. The most significant portion of this expense relates to the stock option for our Chief Executive Officer, granted in February 2000 for 5% of all classes of our outstanding common stock. For accounting purposes, the option was treated as a stock appreciation right prior to our demutualization. Since the date of demutualization, or November 13, 2000, variable accounting treatment has been required for this option. As a result, this expense fluctuates, on a quarter-to-quarter basis, based on changes in the value of the Class B shares, which represent trading rights on our exchange, and the Class A shares. Since demutualization, there has not been an independent established trading market for Class A shares and shares of Class A common stock can only be sold or acquired as part of a bundle with the Class B share and the associated trading right. Therefore, the value of the Class A shares at the end of each reporting period is based on the recent prices for the bundle and recent prices relating to the trading rights only. As a result of variable accounting for the option, this expense, and ultimately our operating results, will be subject to significant fluctuation related to volatility in the value of our Class A common stock and the underlying trading rights on the exchange associated with our Class B common stock. This volatility may be unrelated to our operating performance. In the second quarter of 2001, restricted stock grants were awarded to certain employees and fixed accounting treatment is required for these grants. The expense associated with these grants comprises the balance of our stock-based compensation expense.

Occupancy costs consist primarily of rent, maintenance and utilities for our offices, trading facilities and remote data center. Our office space is primarily in Chicago, although smaller offices are located in Washington, D.C., London and Tokyo. Occupancy costs are relatively stable, although our trading floor rent fluctuates to a limited extent based on open outcry trading volume.

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Professional fees, outside services and licenses expense consists primarily of consulting services provided for major technology initiatives, license fees paid as a result of trading volume in stock index products and legal and accounting fees. This expense fluctuates primarily as a result of changes in requirements for consultants to complete technology initiatives, stock index product trading volume changes that impact license fees and other undertakings that require the use of professional services.

Communications and computer and software maintenance expense consists primarily of costs for network connections with our GLOBEX customers; maintenance of the hardware and software required to support our technology; telecommunications costs of our exchange; and fees paid for access to market data. This expense is affected primarily by the growth of electronic trading. Our computer and software maintenance costs are driven by the number of transactions processed, not the volume of contracts traded. Currently, we process approximately 70% of total transactions electronically, which represent approximately 25% of total contracts traded.

Depreciation and amortization expense results from the depreciation of fixed assets purchased, as well as amortization of purchased and internally developed software. This expense increased as a result of significant technology investments in equipment and software that began in late 1998 and led to additional depreciation and amortization in the following years.

Public relations and promotion expense consists primarily of media, print and other advertising expenses, as well as expenses incurred to introduce new products and promote our existing products and services. Also included are seminar, conference and convention expenses for attending trade shows.

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Other expense consists primarily of travel, staff training, fees incurred in providing product delivery services to customers, stipends for the Board of Directors, interest for equipment purchased under capital leases, meals and entertainment, fees for our credit facility and various state and local taxes. Other expense fluctuates, in part, due to changes in demand for our product delivery services and decisions regarding the manner in which to purchase capital equipment. Certain expenses, such as those for travel and entertainment, are more discretionary in nature and can fluctuate from year to year as a result of management decisions.

### Restatement

We have restated our consolidated financial statements for the quarters ended March 31, 2002 and 2001. This Form 10-Q/A includes all adjustments relating to the restatement for all such periods. The restatement relates to a change in the accounting for the stock option granted to our Chief Executive Officer. On November 13, 2000, the date of demutualization, we elected to account for all stock options in accordance with APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. In consultation with our prior auditors, Arthur Andersen LLP, fixed accounting treatment was adopted on the date of demutualization for the Class A shares included in this option. During the second quarter of 2001, variable accounting was adopted for the Class B shares included in this option. Our current auditors, Ernst & Young LLP, have advised that, in their view, variable accounting was appropriate for the entire option since the date of demutualization. This conclusion was reached based on the view that one accounting treatment is required for all classes of stock included in this option and that, as a result of certain stipulations within the option agreement, variable accounting treatment is required. We have accepted this conclusion, and adopted the change.

As a result of the restatement, the impact on net income and earnings per share is as follows for the periods presented (in thousands):

	Three Months Ended	
	March 31, 2002	March 31, 2001
Net income, as reported	\$ 17,109	\$ 19,990
Decrease (increase) in stock-based compensation expense	9,310	(3,431)
Tax effect	(3,697)	1,382
Net income, as restated	\$ 22,722	\$ 17,941
Earnings per share, as reported:		
Basic	\$ 0.59	\$ 0.69

	<u>Three Months Ended</u>	
Diluted	\$ 0.57	\$ 0.69
Earnings per share, as restated:		
Basic	\$ 0.79	\$ 0.62
Diluted	\$ 0.76	\$ 0.62

This change has no impact on our previously reported cash flows and no material balance sheet impact.

The following discussion of our results of operations incorporates the restatements described above.

## Results of Operations for the Three Months Ended March 31, 2002 Compared to the Three Months Ended March 31, 2001

### Overview

Our operations for the three months ended March 31, 2002 resulted in net income of \$22.7 million compared to net income of \$17.9 million for the three months ended March 31, 2001. The primary factor for the increase is the impact of non-cash stock-based compensation expense, which is primarily driven by the change in the value of the Class B shares and the associated trading rights and the Class A shares, and represented a negative expense of \$5.2 million in the first quarter of 2002 compared to an expense of \$3.5 million for the same time period in 2001. Excluding stock-based compensation, net income for the three months ended March 31, 2002 would have been \$19.6 million and for the three months ended March 31, 2001 would have been \$20.0 million. In the first quarter of 2002, volume incentive programs, which include limits on GLOBEX fees for E-mini contracts and volume discounts to benefit large customers trading our Eurodollar products, combined with a decrease in the percentage of trades attributed to non-members, have resulted in lower average revenue per contract. When

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combined with increased expenses, the result has been that our operating margin, excluding stock-based compensation, declined for the three months ended March 31, 2002 to 32.4% from 36.2% for the same period in 2001. The increased expenses in the first quarter of 2002 are attributed primarily to additional headcount, legal fees and advertising.

Trading volume for the first quarter of 2002 totaled a record 120.5 million contracts, or 30.0% above the 92.7 million contracts traded during the first quarter of 2001. The first quarter of 2002 was the fifth consecutive calendar quarter when new total volume records have been established. In the first three months of 2002, investors traded a record number of interest rate and stock index contracts to protect portfolios against market swings and possible U.S. Federal Reserve Board policy changes. Several trading volume records were established during the three months ended March 31, 2002. For example, March 7, 2002 total trading volume of 3,542,992 contracts established a new single-day volume record. On March 6, 2002, trading volume on GLOBEX totaled 704,711 contracts, marking the first time GLOBEX volume exceeded 700,000 contracts in a single trading day.

### Revenues

Total revenues increased \$11.9 million, or 12.9%, from \$92.2 million for the three months ended March 31, 2001 to \$104.1 million for the three months ended March 31, 2002. Net revenues increased \$8.9 million, or 9.7%, from the first quarter of 2001, when no securities lending activity occurred, to the first quarter of 2002. The increase in revenues is primarily attributable to a 34.3% increase in average daily trading volume. In the first quarter of 2002, electronic trading represented 25.3% of total trading volume and grew 94.5%, to an average of 507,891 contracts per day, compared to the first quarter of 2001. These increased volume levels resulted from customers continued uncertainty over interest rates and volatility in U.S. stocks. Partially offsetting these volume gains in 2002 was a decline in rates earned on our investment portfolio and a decrease in the trading revenue generated by our foreign exchange trading subsidiary, GFX.

*Clearing and Transaction Fees.* Clearing and transaction fees, which include clearing fees, GLOBEX electronic trading fees and other volume-related charges, increased \$7.0 million, or 9.8%, from \$70.9 million for the three months ended March 31, 2001 to \$77.9 million for the three months ended March 31, 2002. The increase was attributed primarily to the 34.3% increase in average daily trading volume that included a 94.5% increase in GLOBEX average daily trading volume in the first quarter of 2002 when compared to the same period in 2001. While volume discounts and limits on certain GLOBEX fees were in effect during both 2001 and 2002, the clearing and transaction fees for the first quarter of 2002 were more adversely impacted by these programs and as a result, the growth in revenue was less than the growth in trading volume. The volume discounts for our Eurodollar products that were implemented in January 2001 were expanded in the third quarter of 2001. While volume in Eurodollar contracts has grown, the larger volume discounts have partially offset the additional revenue generated by the increased trading volume in Eurodollars. Similarly, the growth in trading volume associated with our E-mini products has not generated a corresponding increase in transaction fees since there are limits on certain GLOBEX fees. In addition, the first quarter of 2002 had two fewer business days than the first

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quarter of 2001. Finally, there was a decrease in the percentage of trades attributed to non-members from the first quarter of 2001 to the first quarter of 2002. Higher fees are charged to non-member customers than to members.

The following table shows the average daily trading volume in our four product areas and the portion that is traded electronically through the GLOBEX platform:

Product Area	Three Months Ended March 31,		Percentage Increase/ (Decrease)
	2002	2001	
Interest Rate	1,295,186	991,902	30.6%
Equity	585,633	377,736	55.0
Foreign Exchange	96,032	86,262	11.3
Commodity	31,808	39,480	(19.4)
<b>Total Volume</b>	<b>2,008,659</b>	<b>1,495,380</b>	<b>34.3</b>
GLOBEX Volume	507,891	261,132	94.5
GLOBEX Volume as a Percent of Total Volume	25.3%	17.5%	

Even though the U.S. Federal Reserve Board left interest rates unchanged during the first quarter of 2002, compared to three reductions during the first quarter of 2001, we still experienced a 30.6% increase in average

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daily volume for our interest rate products. We believe this growth in volume in our interest rate products provides evidence of our Eurodollar products' status as global benchmarks for managing risk. We also experienced significant volume increases in our equity products during the first quarter of 2002 when compared to the same time period in 2001. Approximately 77% of our equity index product volume is conducted through the GLOBEX platform. More access choices, improved performance of this platform and continued volatility in the U.S. stock market resulted in this growth in volume for our equity products. With respect to foreign exchange products, we began offering side-by-side electronic and open outcry trading of these products in April 2001. This is the primary factor that resulted in the increase in volume in foreign exchange products in the first quarter of 2002 when compared to the first quarter of 2001. The decline in commodity trading volume resulted from lower price levels for livestock and milk, which tends to depress trading volume in these products. Expectations of upward price trends for these commodities also led producers to postpone hedging activity.

*Quotation Data Fees.* Quotation data fees increased \$2.3 million, or 21.9%, from \$10.2 million for the three months ended March 31, 2001 to \$12.5 million for the three months ended March 31, 2002. This increase resulted from several factors. Fees for our quotation data services were increased March 1, 2001, so the full benefit of these increases was not realized in the first quarter of 2001. Also, a large vendor's bankruptcy filing in February 2001 had an adverse impact on our revenue for the three months ended March 31, 2001. In addition, in 2002 we implemented an administrative fee for our quote vendor services, and in March 2002 we began to offer our market data through the Internet resulting in modest additional revenue.

*GLOBEX Access Fees.* GLOBEX access fees increased \$0.8 million, or 33.4%, from \$2.3 million for the three months ended March 31, 2001 to \$3.1 million for the three months ended March 31, 2002. In addition to growth in the number of GLOBEX users, access fees were increased on February 1, 2001, and additional access choices were offered.

*Communication Fees.* Communication fees increased \$0.1 million, or 6.6%, from \$2.3 million for the three months ended March 31, 2001 to \$2.4 million for the three months ended March 31, 2002.

*Investment Income.* Investment income decreased \$1.0 million, or 37.2%, from \$2.6 million for the three months ended March 31, 2001 to \$1.6 million for the three months ended March 31, 2002. The decline resulted primarily from reduced earnings generated through the investment of cash performance bonds and security deposits. Rates earned on these investments declined significantly from the first quarter of 2001 to the first quarter of 2002. Partially offsetting this decline was increased investment income generated by our investment portfolio and non-qualified deferred compensation plans during the three months ended March 31, 2002 when compared to the same period in 2001. Our improved financial performance has resulted in additional funds available for investment, causing investment income of this nature to grow despite the decrease in interest rates earned on these investments. There was a \$0.5 million increase in the investment results of our non-qualified deferred compensation plan that is included in investment income but did not affect our net income, as there was an equal increase in our salaries and benefits expense.

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*Securities Lending Interest Income and Expense.* Securities lending interest income was \$3.5 million for the three months ended March 31, 2002. There was no similar income for the three months ended March 31, 2001, as our securities lending activity began in June 2001. Securities lending is limited to a portion of the securities that clearing firms deposit to satisfy their proprietary performance bond requirements. Securities lending interest expense was \$3.0 million for the three months ended March 31, 2002. There was no similar expense for the three months ended March 31, 2001. This expense is an integral part of our securities lending program and is required to engage in securities lending transactions. Therefore, this expense is presented in the statements of income as a reduction of total revenues.

*Other Revenue.* Other revenue decreased \$0.7 million, or 20.3%, from \$3.8 million for the three months ended March 31, 2001 to \$3.1 million for the three months ended March 31, 2002. This decrease is primarily attributed to a \$0.9 million decrease in trading revenue generated by GFX and \$0.5 million for our share of the net loss of OneChicago, LLC for the three months ended March 31, 2002. These decreases were partially offset by a \$0.6 million increase in fees associated with managing our IEF program.

### Expenses

Total operating expenses increased \$0.9 million, or 1.5%, from \$62.3 million for the three months ended March 31, 2001 to \$63.2 million for the three months ended March 31, 2002. This increase was attributable

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primarily to increases in salaries and benefits, professional fees and depreciation and amortization. Partially offsetting this was a decrease of \$8.7 million in stock-based compensation expense. Excluding stock-based compensation, which is a non-cash expense, expenses would have increased \$9.6 million, or 16.3%.

*Salaries and Benefits Expense.* Salaries and benefits increased \$4.1 million, or 16.6%, from \$25.1 million for the three months ended March 31, 2001 to \$29.2 million for the three months ended March 31, 2002. The largest component of this increase was growth in salaries. We had fewer employees in the first quarter of 2001, primarily as a result of the tight labor market that still existed at that time, particularly in the technology sector. As labor market conditions softened, this allowed us to attract additional staff for positions that were previously unfilled. This increase in the number of employees, as well as a rise in general compensation levels, resulted in an increase in salaries and in expenses relating to our bonus, benefit plans and employer taxes.

*Stock-Based Compensation Expense.* Stock-based compensation expense decreased \$8.7 million, from \$3.5 million for the three months ended March 31, 2001 to a negative expense of \$5.2 million for the three months ended March 31, 2002. The primary component of this expense relates to the stock option granted to our CEO in February 2000, which includes both Class A and Class B shares of common stock. Variable accounting treatment is required for the option granted to our CEO. Because variable accounting reflects the change in the value of our Class A common stock and the underlying trading rights on the exchange associated with our Class B common stock, there is the possibility for significant variation in this component of stock-based compensation expense. In the three-month period ended March 31, 2002, there was a decrease in the value of the Class A shares that was only partially offset by an increase in the value of the Class B shares, and the associated trading rights, included in this option. The overall decline in the value of this option resulted in the negative expense in the first quarter of 2002. By contrast, in the three-month period ended March 31, 2001, the increase in the value of the Class B shares, and the associated trading rights, was greater than the decline in the value of the Class A shares, resulting in \$3.5 million of expense for the first quarter of 2001. In addition, some restricted stock grants were awarded to employees in the second quarter of 2001 and fixed accounting treatment was adopted for these grants. A portion of the expense relating to these grants is included in stock-based compensation for the three months ended March 31, 2002. There was no similar expense for the three months ended March 31, 2001.

*Occupancy Expense.* Occupancy expense increased \$0.5 million, or 10.0%, from \$5.3 million for the three months ended March 31, 2001 to \$5.8 million for the three months ended March 31, 2002. This increase is related directly to increased trading volume, as a portion of our rent is determined based on our open outcry volume, and we incurred additional rent expense in 2002 for a remote data facility leased in the fourth quarter of 2001.

*Professional Fees, Outside Services and Licenses Expense.* Professional fees, outside services and licenses expense increased \$1.3 million, or 20.7%, from \$6.0 million for the three months ended March 31, 2001 to \$7.3 million for the three months ended March 31, 2002. This increase is attributed primarily to a \$0.7 million increase in the first quarter of 2002 for legal fees associated with our defense in litigation relating to Wagner patent 4,903,201. In addition, in 2002 there was a \$0.2 million increase in license fees resulting from growth in our equity product trading volume, as well as additional expenses incurred for building security since the September 11 terrorist attacks. Partially offsetting these increases was a \$0.3 million reduction in professional fees for technology-related initiatives, as professional fees related to new initiatives were less than those incurred in the first quarter of 2001 for initiatives that have since been completed.

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*Communications and Computer and Software Maintenance Expense.* Communications and computer and software maintenance expense increased \$0.3 million, or 3.2%, from \$10.0 million for the three months ended March 31, 2001 to \$10.3 million for the three months ended March 31, 2002. The increase in 2002 resulted from additional maintenance and supplies costs associated with recent technology purchases for hardware and software. These increases were offset partially by a reduction in communication expenses associated with connections to our GLOBEX platform. The contract with this vendor was renegotiated in 2001, resulting in lower costs for the first quarter of 2002 despite increased access to GLOBEX.

*Depreciation and Amortization Expense.* Depreciation and amortization expense increased \$1.9 million, or 21.7%, from \$8.9 million for the three months ended March 31, 2001 to \$10.8 million for the three months ended March 31, 2002. This increase was attributable primarily to depreciation of the cost of equipment purchased late in 2001 as well as amortization on software purchased or completed after the first quarter of 2001.

*Public Relations and Promotions Expense.* Public relations and promotions expense increased \$1.0 million, from \$0.6 million for the three months ended March 31, 2001 to \$1.6 million for the three months ended

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March 31, 2002. The increase resulted from additional print advertising expenditures in the first quarter of 2002 primarily to promote our E-mini equity index products.

*Other Expense.* Other expense increased \$0.4 million, or 14.7%, from \$3.0 million for the three months ended March 31, 2001 to \$3.4 million for the three months ended March 31, 2002. This increase in 2002 related primarily to increased administrative expenses, such as bank fees and travel.

### **Income Tax Provision**

We recorded a tax provision of \$15.2 million for the quarter ended March 31, 2002 compared to a tax provision of \$12.0 million for the same period in 2001. The effective tax rate was 40.0% for the first quarter of 2002, unchanged from the first quarter of 2001.

### **Liquidity and Capital Resources**

Cash and cash equivalents totaled \$65.9 million at March 31, 2002 and \$69.1 million at December 31, 2001. The \$3.2 million decrease since December 31, 2001 resulted from payment of certain short-term liabilities during the first quarter of 2002 that is reflected, in part, by a reduction in accounts payable during the same time period.

Other current assets readily convertible into cash would include investments as well as accounts receivable. When combined with cash and cash equivalents, these assets represented 60.5% of our total assets, excluding cash performance bonds and security deposits and investment of securities lending proceeds, at March 31, 2002, relatively unchanged from 60.9% at December 31, 2001. Cash performance bonds and security deposits as well as investment of securities lending proceeds are excluded from total assets for purposes of this comparison as these assets may vary significantly over time.

Historically, we have met our funding requirements from operations. Net cash provided by operating activities was \$19.0 million for the three months ended March 31, 2002 compared to \$24.1 million for the three months ended March 31, 2001, a decrease of \$5.1 million. This decrease resulted primarily from cash utilized to achieve a \$7.6 million reduction in other current liabilities and accounts payable from year-end 2001 to March 31, 2002. This reduction in liabilities related to payment of staff bonuses, membership sale proceeds and general operating expenses during the first quarter of 2002. These decreases were partially offset by increases in non-cash items such as depreciation and the loss on our investment in OneChicago, LLC during the first quarter of 2002.

Cash used in investing activities was \$20.8 million for the three months ended March 31, 2002 compared to \$21.2 million for the three months ended March 31, 2001. Cash outlays for property increased \$1.5 million, from \$10.5 million for the first quarter of 2001 to \$12.0 million for the first quarter of 2002. An additional investment in OneChicago was also made in the first quarter of 2002 for \$3.1 million. Net purchases of investments, however, decreased \$4.9 million, from \$10.7 million for the three months ended March 31, 2001 to \$5.8 million for the three months ended March 31, 2002. The first quarter of 2002 demonstrates our continued ability to fund capital expenditures from current operating funds and to increase our investment portfolio.

Cash used in financing activities was \$1.3 million for the three months ended March 31, 2002 and \$1.0 million for the three months ended March 31, 2001. For both quarters this represents regularly scheduled payments on long-term debt. No additional debt was incurred.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk****Overview**

Market risk represents interest rate risk relating to the investments held by us as well as derivative trading risk associated with GFX. With respect to interest rate risk, a change in market interest rates would impact interest income from temporary cash investments, cash performance bonds and security deposits, variable rate investment securities and new purchases of investment securities. Changes in market interest rates would also have an effect on the fair value of investment securities held. GFX engages in the purchase and sale of our foreign exchange futures contracts to promote liquidity in our products and subsequently enters into offsetting transactions using futures contracts or spot foreign exchange transactions to limit market risk. Net position limits are established for each trader and currently amount to \$12.0 million in aggregate notional value.

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**Interest Rate Risk**

Interest income from investment securities, temporary cash investments, cash performance bonds and security deposits was \$1.5 million in the first quarter of 2002. At March 31, 2002, our investment portfolio consisted primarily of U.S. government agency and state and municipal securities, including approximately \$3.9 million in variable rate securities. Our investment portfolio recorded realized and unrealized losses of \$0.6 million in the three months ended March 31, 2002 compared to realized and unrealized gains of \$0.4 million in the three months ended March 31, 2001. Contractual maturities and interest coupon rates for fixed rate investment securities at March 31, 2002 were as follows (dollars in thousands):

Year	Principal Amount	Weighted Average Interest Rate
2002	\$ 1,000	6.0%
2003	5,870	4.8
2004	24,335	5.1
2005	27,031	4.9
2006	24,185	5.3
2007	6,815	4.7
2008	2,000	6.1
Total	\$ 91,236	4.6%
Fair Value	\$ 92,850	

**Derivative Trading Risk**

At March 31, 2002, GFX held futures positions with a notional value of \$40.0 million, offset by a similar amount of spot foreign exchange positions. All positions are marked to market through a charge or credit to income on a daily basis. Net trading gains were \$0.4 million for the three months ended March 31, 2002 and \$1.3 million for the three months ended March 31, 2001.

**PART II. OTHER INFORMATION****Item 6. Exhibits and Reports on Form 8-K**

(a)

Exhibits:





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(2) Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report; and

(3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: September 26, 2002

/s/ DAVID G. GOMACH

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Name: David G. Gomach  
Title: Chief Financial Officer

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CHICAGO MERCANTILE EXCHANGE HOLDINGS INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (dollars in thousands, except share data) (unaudited and restated)

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