

MARKETAXESS HOLDINGS INC

Form 10-Q

October 26, 2011

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2011

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 001-34091
MARKETAXESS HOLDINGS INC.**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

52-2230784

(IRS Employer Identification No.)

299 Park Avenue, 10th Floor New York, New York

(Address of principal executive offices)

10171

(Zip Code)

(212) 813-6000

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of October 25, 2011, the number of shares of the Registrant's voting common stock outstanding was 35,578,526 and the number of shares of the Registrant's non-voting common stock was 2,585,654.

MARKETAXESS HOLDINGS INC.
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MARKETAXESS HOLDINGS INC.
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
(Unaudited)

	As of	
	September 30, 2011	December 31, 2010
	(In thousands, except share and per share amounts)	
ASSETS		
Cash and cash equivalents	\$ 157,622	\$ 124,994
Securities available-for-sale, at fair value	80,200	72,552
Accounts receivable, net of allowance of \$191 and \$427 as of September 30, 2011 and December 31, 2010, respectively	31,858	25,682
Deferred tax assets, net	9,589	19,813
Goodwill and intangible assets, net of accumulated amortization	34,911	36,012
Furniture, equipment, leasehold improvements and capitalized software, net of accumulated depreciation and amortization	14,076	12,545
Prepaid expenses and other assets	10,944	7,923
Total assets	\$ 339,200	\$ 299,521
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities		
Accrued employee compensation	\$ 15,672	\$ 17,791
Deferred revenue	5,037	4,571
Accounts payable, accrued expenses and other liabilities	12,658	12,368
Total liabilities	33,367	34,730
Commitments and Contingencies (Note 10)		
Series B Preferred Stock , \$0.001 par value, 35,000 shares authorized; zero and 35,000 issued and outstanding as of September 30, 2011 and December 31, 2010, respectively		30,315
Stockholders equity		
Preferred stock, \$0.001 par value, 4,855,000 shares authorized, no shares issued and outstanding as of September 30, 2011 and December 31, 2010		
Series A Preferred Stock, \$0.001 par value, 110,000 shares authorized, no shares issued and outstanding as of September 30, 2011 and December 31, 2010	110	108

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Common stock voting, \$0.003 par value, 110,000,000 shares authorized, 36,882,267 shares and 35,945,001 shares issued and 35,578,526 shares and 31,141,261 shares outstanding as of September 30, 2011 and December 31, 2010, respectively

Common stock non-voting, \$0.003 par value, 10,000,000 shares authorized, 2,585,654 shares issued and outstanding as of September 30, 2011 and December 31, 2010

Additional paid-in capital	9	9
Treasury stock Common stock voting, at cost, 1,303,741 shares and 4,803,740 shares as of September 30, 2011 and December 31, 2010, respectively	335,084	340,615
Accumulated deficit	(18,998)	(70,000)
Accumulated other comprehensive loss	(8,680)	(34,605)
	(1,692)	(1,651)
Total stockholders equity	305,833	234,476
Total liabilities and stockholders equity	\$ 339,200	\$ 299,521

The accompanying notes are an integral part of these consolidated financial statements.

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MARKETAXESS HOLDINGS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
	(In thousands, except per share amounts)			
Revenues				
Commissions				
U.S. high-grade	\$ 28,017	\$ 21,537	\$ 81,225	\$ 61,562
Eurobond	4,443	4,075	13,666	14,236
Other	7,362	5,540	21,792	14,121
Total commissions	39,822	31,152	116,683	89,919
Technology products and services	3,779	3,455	10,871	9,870
Information and user access fees	1,831	1,603	5,239	4,959
Investment income	303	301	912	907
Other	829	902	2,259	1,968
Total revenues	46,564	37,413	135,964	107,623
Expenses				
Employee compensation and benefits	13,707	14,326	45,079	42,448
Depreciation and amortization	1,799	1,560	4,988	4,798
Technology and communications	2,772	2,543	7,996	7,313
Professional and consulting fees	2,247	2,241	7,784	6,369
Occupancy	721	706	2,195	2,351
Marketing and advertising	1,280	679	3,502	2,066
General and administrative	1,742	1,834	4,553	5,813
Total expenses	24,268	23,889	76,097	71,158
Income before income taxes	22,296	13,524	59,867	36,465
Provision for income taxes	8,852	4,913	23,706	13,984
Net income	\$ 13,444	\$ 8,611	\$ 36,161	\$ 22,481
Net income per common share				
Basic	\$ 0.36	\$ 0.24	\$ 0.98	\$ 0.61
Diluted	\$ 0.34	\$ 0.22	\$ 0.91	\$ 0.57
Cash dividends declared per common share	\$ 0.09	\$ 0.07	\$ 0.27	\$ 0.21
Weighted average common shares				
Basic	37,126	32,945	36,798	33,434
Diluted	39,828	38,744	39,539	39,188

The accompanying notes are an integral part of these consolidated financial statements.

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MARKETAXESS HOLDINGS INC.
CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS EQUITY
AND ACCUMULATED OTHER COMPREHENSIVE LOSS
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011
(Unaudited)

	Common			Treasury Stock -		Accumu- lated Other Comprehen- sive Loss	Total Stock- holders Equity
	Common Stock Voting	Stock Non- Voting	Additional Paid-In Capital	Common Stock Voting	Accumu- lated Deficit		
Balance at December 31, 2010	\$ 108	\$ 9	\$ 340,615	\$ (70,000)	\$ (34,605)	\$ (1,651)	\$ 234,476
Comprehensive income:							
Net income					36,161		36,161
Cumulative translation adjustment and foreign currency exchange hedge, net of tax						(509)	(509)
Unrealized net gain on securities available-for-sale, net of tax						468	468
Total comprehensive income							36,120
Stock-based compensation			4,997				4,997
Exercise of stock options and grants of restricted stock, net of surrenders on stock option exercises and withholding tax on stock vesting	2		447				449
Cash dividend on common stock					(10,236)		(10,236)
Conversion of Series B Preferred Stock to common stock voting			(20,687)	51,002			30,315
Tax benefit from the exercise of warrants in prior years			4,239				4,239
Windfall tax benefits from stock-based compensation			5,473				5,473
Balance at September 30, 2011	\$ 110	\$ 9	\$ 335,084	\$ (18,998)	\$ (8,680)	\$ (1,692)	\$ 305,833

The accompanying notes are an integral part of these consolidated financial statements.

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MARKETAXESS HOLDINGS INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Nine Months Ended September 30,	
	2011	2010
	(In thousands)	
Cash flows from operating activities		
Net income	\$ 36,161	\$ 22,481
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	4,988	4,798
Stock-based compensation expense	4,997	6,628
Deferred taxes	14,496	10,982
Provision for bad debts	56	389
Gain on sale of securities		(411)
Changes in operating assets and liabilities		
(Increase) in accounts receivable	(6,232)	(4,559)
(Increase) decrease in prepaid expenses and other assets	(6,519)	450
(Decrease) in accrued employee compensation	(2,119)	(1,606)
Increase in deferred revenue	466	616
Increase in accounts payable, accrued expenses and other liabilities	497	1,815
Net cash provided by operating activities	46,791	41,583
Cash flows from investing activities		
Securities available-for-sale:		
Proceeds from maturities and sales	20,845	55,480
Purchases	(27,719)	(57,194)
Securities and cash provided as collateral	3,498	28
Purchases of furniture, equipment and leasehold improvements	(2,517)	(4,684)
Capitalization of software development costs	(2,898)	(1,331)
Net cash (used in) investing activities	(8,791)	(7,701)
Cash flows from financing activities		
Cash dividend on common stock and Series B Preferred Stock	(10,236)	(8,039)
Purchase of treasury stock		(23,258)
Proceeds from exercise of stock options and grants of restricted stock, net of surrenders on stock option exercises and withholding tax on stock vesting	449	1,958
Windfall tax benefits from stock-based compensation	5,473	906
Other	(207)	522
Net cash (used in) financing activities	(4,521)	(27,911)
Effect of exchange rate changes on cash and cash equivalents	(851)	(567)
Cash and cash equivalents		

Net increase for the period	32,628	5,404
Beginning of year	124,994	103,341
End of period	\$ 157,622	\$ 108,745

Supplemental cash flow information**Cash paid during the period:**

Income taxes paid	\$ 9,574	\$ 1,638
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Non-cash activity:

Conversion of Series B Preferred Stock to common stock	\$ 30,315	\$
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The accompanying notes are an integral part of these consolidated financial statements.

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MarketAxess Holdings Inc. (the Company) was incorporated in the State of Delaware on April 11, 2000. Through its subsidiaries, the Company operates an electronic trading platform for corporate bonds and other types of fixed-income instruments through which the Company's institutional investor clients can access the liquidity provided by its broker-dealer clients. The Company's multi-dealer trading platform allows its institutional investor clients to simultaneously request competitive, executable bids or offers from multiple broker-dealers, and to execute trades with the broker-dealer of their choice. The Company offers its clients the ability to trade U.S. high-grade corporate bonds, European high-grade corporate bonds, credit default swaps, agencies, high yield and emerging markets bonds and asset-backed and preferred securities. The Company also executes certain bond transactions between and among institutional investor and broker-dealer clients on a riskless principal basis by serving as counterparty to both the buyer and the seller in matching back-to-back trades, which then settle through a third-party clearing organization. Through its Corporate BondTicker service, the Company provides fixed-income market data, analytics and compliance tools that help its clients make trading decisions. In addition, the Company provides FIX (Financial Information eXchange) message management tools, connectivity solutions and ancillary technology services that facilitate the electronic communication of order information between trading counterparties.

For 2011 and 2010, JPMorgan Chase & Co. was the Company's sole stockholder broker-dealer client (the Stockholder Broker-Dealer Client). This broker-dealer client constituted a related party of the Company. See Note 7, Related Party.

2. Significant Accounting Policies***Basis of Presentation***

The consolidated financial statements include the accounts of the Company and its subsidiaries. All intercompany transactions and balances have been eliminated. These consolidated financial statements are unaudited and should be read in conjunction with the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2010. The consolidated financial information as of December 31, 2010 has been derived from audited financial statements not included herein.

These unaudited consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the U.S. Securities and Exchange Commission (SEC) with respect to Form 10-Q and reflect all adjustments that, in the opinion of management, are normal and recurring, and that are necessary for a fair statement of the results for the interim periods presented. In accordance with such rules and regulations, certain disclosures that are normally included in annual financial statements have been omitted. Interim period operating results may not be indicative of the operating results for a full year.

Cash and Cash Equivalents

Cash and cash equivalents includes cash and money market instruments that are primarily maintained at one major global bank. Given this concentration, the Company is exposed to certain credit risk. The Company defines cash equivalents as short-term interest-bearing investments with maturities at the time of purchase of three months or less.

Securities Available-for-Sale

The Company classifies its marketable securities as available-for-sale securities. Unrealized marketable securities gains and losses, net of taxes, are reflected as a net amount under the caption of accumulated other comprehensive loss in the Consolidated Statements of Financial Condition. Realized gains and losses are recorded in the Consolidated Statements of Operations in other revenues. For the purpose of computing realized gains and losses, cost is determined on a specific identification basis.

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The Company assesses whether an other-than-temporary impairment loss on the investments has occurred due to declines in fair value or other market conditions. The portion of an other-than-temporary impairment related to credit loss is recorded as a charge in the Consolidated Statements of Operations. The remainder is recognized in other comprehensive loss if the Company does not intend to sell the security and it is more likely than not that the Company will not be required to sell the security prior to recovery. No charges for other-than-temporary losses were recorded during the nine months ended September 30, 2011 and 2010.

Fair Value Financial Instruments

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. A three-tiered fair value hierarchy for determining fair value has been established that prioritizes inputs to valuation techniques used in fair value calculations. The three levels of inputs are defined as Level 1 (unadjusted quoted prices for identical assets or liabilities in active markets), Level 2 (inputs that are observable in the marketplace other than those inputs classified in Level 1) and Level 3 (inputs that are unobservable in the marketplace). The Company's financial assets and liabilities measured at fair value on a recurring basis consist of its money market funds, securities available-for-sale portfolio and one foreign currency forward contract.

Allowance for Doubtful Accounts

All accounts receivable have contractual maturities of less than one year and are derived from trading-related fees and commissions and revenues from products and services. The Company continually monitors collections and payments from its clients and maintains an allowance for doubtful accounts. The allowance for doubtful accounts is based upon the historical collection experience and specific collection issues that have been identified. Additions to the allowance for doubtful accounts are charged to bad debt expense, which is included in general and administrative expense in the Company's Consolidated Statements of Operations.

Depreciation and Amortization

Fixed assets are carried at cost less accumulated depreciation. The Company uses the straight-line method of depreciation over three to seven years, which is indicative of the estimated useful life of the assets. Leasehold improvements are stated at cost and are amortized using the straight-line method over the lesser of the life of the improvement or the remaining term of the lease.

Software Development Costs

The Company capitalizes certain costs associated with the development of internal use software at the point at which the conceptual formulation, design and testing of possible software project alternatives have been completed. The Company capitalizes employee compensation and related benefits and third party consulting costs incurred during the preliminary software project stage. Once the product is ready for its intended use, such costs are amortized on a straight-line basis over three years. The Company reviews the amounts capitalized for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable.

Cash Provided as Collateral

Cash is provided as collateral for electronic bank settlements and broker-dealer clearance accounts. Cash provided as collateral is included in prepaid expenses and other assets in the Consolidated Statements of Financial Condition.

Foreign Currency Translation and Forward Contracts

Assets and liabilities denominated in foreign currencies are translated using exchange rates at the end of the period; revenues and expenses are translated at average monthly rates. Gains and losses on foreign currency translation are a component of accumulated other comprehensive loss in the Consolidated Statements of Financial Condition. Transaction gains and losses are recorded in general and administrative expense in the Consolidated Statements of Operations.

The Company enters into foreign currency forward contracts to hedge its net investment in its U.K. subsidiary. Gains and losses on these transactions are included in accumulated other comprehensive loss in the Consolidated Statements of Financial Condition.

Table of Contents***Revenue Recognition***

The majority of the Company's revenues are derived from commissions for trades executed on its platform that are billed to its broker-dealer clients on a monthly basis. The Company also derives revenues from technology products and services, information and user access fees, investment income and other income.

Commission revenue. Commissions are generally calculated as a percentage of the notional dollar volume of bonds traded on the platform and vary based on the type and maturity of the bond traded. Under the Company's transaction fee plans, bonds that are more actively traded or that have shorter maturities are generally charged lower commissions, while bonds that are less actively traded or that have longer maturities generally command higher commissions. Under certain fee plans, broker-dealer clients pay monthly distribution fees. For trades that the Company executes between and among institutional investor and broker-dealer clients on a riskless principal basis by serving as counterparty to both the buyer and the seller, the Company earns the commission through the difference in price between the two back-to-back trades.

Technology products and services. The Company generates revenues from technology software licenses, maintenance and support services (referred to as post-contract technical support or PCS) and professional consulting services. Revenue is generally recognized when persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collection is considered probable. The Company generally sells software licenses and PCS together as part of multiple-element arrangements. The Company also enters into contracts for technology integration consulting services unrelated to any software product.

For arrangements that include multiple elements, generally software licenses and PCS, we allocate and defer revenue for the undelivered items based on vendor specific objective evidence (VSOE) of the fair value of the undelivered elements and recognize the difference between the total arrangement fee and the amount deferred for the undelivered items as license revenue. VSOE of each element is based on historical evidence of stand-alone sales of these elements to third parties or the stated renewal rate for the undelivered elements. When VSOE does not exist for undelivered items, the entire arrangement fee is recognized ratably over the performance period. For PCS the term is typically one year and revenue is recognized over the duration of the arrangement on a straight-line basis.

Professional consulting services are generally separately priced and are typically not essential to the functionality of the Company's software products. Revenues from these services are recognized separately from the license fee. Generally, revenue from time-and-materials consulting contracts is recognized as services are performed.

Revenues from contracts for technology integration consulting services are recognized on the percentage-of-completion method. Percentage-of-completion accounting involves calculating the percentage of services provided during the reporting period compared to the total estimated services to be provided over the duration of the contract. If estimates indicate that a contract loss will occur, a loss provision is recorded in the period in which the loss first becomes probable and reasonably estimable. Contract losses are determined to be the amount by which the estimated direct and indirect costs of the contract exceed the estimated total revenues that will be generated by the contract. There were no contract loss provisions recorded as of September 30, 2011 and 2010. Revenues recognized in excess of billings are recorded as unbilled services within other assets. Billings in excess of revenues recognized are recorded as deferred revenues until revenue recognition criteria are met.

Initial set-up fees. The Company enters into agreements with its broker-dealer clients pursuant to which the Company provides access to its platform through a non-exclusive and non-transferable license. Broker-dealer clients may pay an initial set-up fee, which is typically due and payable upon execution of the broker-dealer agreement. The initial set-up fee, if any, varies by agreement. Revenue is recognized over the initial term of the agreement, which is generally two years.

Stock-Based Compensation

The Company measures and recognizes compensation expense for all share-based payment awards based on their estimated fair values measured as of the grant date. These costs are recognized as an expense in the Consolidated Statements of Operations over the requisite service period, which is typically the vesting period, with an offsetting increase to additional paid-in capital.

Income Taxes

Income taxes are accounted for using the asset and liability method. Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when such differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is recognized against deferred tax assets if it is more likely than not that such assets will not be realized in future years. The Company recognizes interest and penalties related to unrecognized tax benefits in general and administrative expenses in the Consolidated Statements of Operations.

Table of Contents***Business Combinations, Goodwill and Intangible Assets***

Business acquisitions are accounted for under the purchase method of accounting. The total cost of an acquisition is allocated to the underlying net assets based on their respective estimated fair values. The excess of the purchase price over the estimated fair values of the net assets acquired is recorded as goodwill. Determining the fair value of certain assets acquired and liabilities assumed is judgmental in nature and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash flows, discount rates, growth rates and asset lives.

An impairment review of goodwill is performed on an annual basis and more frequently if circumstances change. Intangible assets with definite lives, including purchased technologies, customer relationships and other intangible assets, are amortized on a straight-line basis over their estimated useful lives, ranging from five to ten years. Intangible assets are assessed for impairment when events or circumstances indicate the existence of a possible impairment.

Earnings Per Share

For 2010, earnings per share (EPS) was calculated using the two-class method. Basic EPS is computed by dividing the net income attributable to common stock by the weighted-average number of shares of common stock outstanding for the period, including consideration of the two-class method to the extent that participating securities were outstanding during the period. Under the two-class method, undistributed net income is allocated to common stock and participating securities based on their respective right to share in dividends. The Series B Preferred Stock was convertible into shares of common stock and also included a right whereby, upon the declaration or payment of a dividend or distribution on the common stock, a dividend or distribution must also be declared or paid on the Series B Preferred Stock based on the number of shares of common stock into which such securities were convertible at the time. Due to these rights, the Series B Preferred Stock was considered a participating security requiring the use of the two-class method for the computation of basic EPS.

In January 2011, all of the shares of the Series B Preferred Stock were mandatorily and automatically converted into shares of common stock. For 2011, basic EPS is computed by dividing the net income attributable to common stock by the weighted-average number of shares of common stock outstanding during the period.

Diluted EPS is computed using the more dilutive of the (a) if-converted method or (b) two-class method. Since the Series B Preferred Stock participated equally with the common stock in dividends and unallocated income, diluted EPS under the if-converted method was and is equivalent to the two-class method. For both 2011 and 2010, the weighted-average shares outstanding of common stock reflects the dilutive effect that could occur if convertible securities or other contracts to issue common stock were converted into or exercised for common stock.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results could differ from those estimates.

Recent Accounting Pronouncements

In October 2009, the Financial Accounting Standards Board (FASB) issued authoritative guidance on revenue recognition. The guidance required entities to allocate revenue in an arrangement with multiple deliverables using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The guidance also removed tangible products from the scope of software revenue guidance and provides guidance on determining whether software deliverables in an arrangement that includes a tangible product are covered by the scope of the software revenue guidance. The Company adopted the new revenue recognition guidance effective January 1, 2011 and there was no material impact on the Company's Consolidated Financial Statements.

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3. Net Capital Requirements and Customer Protection Requirements

MarketAxess Corporation, a U.S. subsidiary, is a registered broker-dealer with the SEC and is a member of the Financial Industry Regulatory Authority (FINRA). MarketAxess Corporation claims exemption from SEC Rule 15c3-3, as it does not hold customer securities or funds on account, as defined. Pursuant to the Uniform Net Capital Rule under the Securities Exchange Act of 1934, MarketAxess Corporation is required to maintain minimum net capital, as defined, equal to the greater of \$100,000 or 6 2/3% of aggregate indebtedness. MarketAxess Europe Limited, a U.K. subsidiary, is registered as a Multilateral Trading Facility with the Financial Services Authority (FSA) in the U.K. MarketAxess Canada Limited, a Canadian subsidiary, is registered as an Alternative Trading System dealer under the Securities Act of Ontario and is a member of the Investment Industry Regulatory Organization of Canada. MarketAxess Europe Limited and MarketAxess Canada Limited are subject to certain financial resource requirements of the FSA and the Ontario Securities Commission, respectively. The following table sets forth the capital requirements, as defined, that the Company s subsidiaries were required to maintain as of September 30, 2011:

	MarketAxess Corporation	MarketAxess Europe Limited (In thousands)	MarketAxess Canada Limited
Net capital	\$		