(grōwth)







defining \eSpeed \

**\eSpeed **(ē' sped)

n. 1. The leading technology provider for the world's financial electronic marketplaces 2. Transforming the way people trade in the fixed income markets 3. The preferred system for unrivaled liquidity and the best prices 4. (informal) Volume, volume, volume

\ESPD\(\text{is}' \text{spēd}) n. 1. Stock symbol of eSpeed, representing a class A stock publicly traded on the NASDAQ* exchange
2. The 25th best performing stock of 2002 on the NASDAQ

\Liquidity\(\(\text{li kwid'i t\(\bar{e}\)}\) \(n.\)

1. Ability to sell or buy quickly in large volume 2. The high level of trading activity experienced when eSpeed's multiple buyers and multiple sellers converge on a marketplace trading an average of \$200 billion over the course of a day 3. Found in abundance on eSpeed

\Neutrality\($n\overline{o}o$ \) tral'\(\text{\$\text{\$\emsign{c}}\$}\) \nu_\).

- **1.** Unbiased **2.** The product of a level playing field
- **3.** A way of describing any eSpeed market

\SuperQuads\

(soo'pər kwodz) n. pl.

1. A screen configuration that encourages viewing multiple instruments in many markets simultaneously, example: the ability to trade in cash and futures at the same time
2. The front-end of the eSpeed trading platform 3. An ideal place to introduce complemen-

| Price Improvement | (prīs im proov' ment) n.

tary financial instruments

1. A tool that allows a trader to slightly increase a bid or offer to improve his/her position in a trading stack 2. An increasingly

popular tool used by traders in many of the markets powered by eSpeed **3.** A magnet for liquidity

\Direct Dealing \

(de rekt' dēl'ing) v. 1. Going one-to-one, one-to-few or one-to-many in an off-market request for quote without picking up the phone 2. The best way to gauge liquidity in an inactive market 3. A way of protecting a trader's anonymity while setting a specified time for a request to be fulfilled and treating all participants equally

\AutoSpeed\(ôt'ō spēd) n.

- 1. Automated trading made simple 2. A Microsoft Excel*-based trading application that allows for auto execution across multiple markets v. 1. Used to instantly model and execute strategies like
- Can combine with intelligent analytics from Unisys to further simplify trading strategy adj.
 Even faster execution, accuracy and efficiency in eSpeed's markets

\Desktop Real Estate\ (desk'tŏp rēl e stāt) n.

- The surface area of a computer screen(s) found on the desktops of traders of interestrate products in the world's biggest financial institutions
- 2. The place traders' eyeballs

call home **3.** "Location, location, location," in a virtual sort of way

\eSpeed Keyboard\ (ē' spēd kē' bôrd') n.

- Device used to unlock
 the maximum potential of
 eSpeed's trading platform
 v. ~ing 1. Working in concert
 with SuperQuads to maximize a
- \CBOT Futures on eSpeed\
 (sē' bŏt fyoo'chərz ôn

trader's position in the market

- ē' spēd) (phrase) 1. A new concept in electronic trading
- 2. The combination of cash and futures on a single screen
- **3.** A giant marketplace formed by joining a global futures market with the world leader in electronic fixed-income trading
- **4.** A way for cash traders to hedge against risk by trading in both cash and futures **5.** A blueprint for future partnerships
- NFXN (ef eks) w. 1. The common term for the Foreign Exchange market 2. The latest instrument trading on eSpeed; neutral and anonymous trading in the largest, most liquid market on earth

\Interest Rate Swaps\ (in'trist rāt swŏps) n. pl.

Switching fixed rate payments for floating rate ones
 One of eSpeed's next product rollouts
 A way to save on execution costs by using

\"When Issued"\ (hwen ish'ood) past participle

- A window of opportunity to trade U.S. treasury securities in advance of issuance
 1. A security with untapped electronic trading potential
- 2. An extension to eSpeed's current suite of products

- Older issues of a given maturity of U.S. Treasuries
 Opposite of On-the-Runs,
- 2. Opposite of On-the-Runs, or benchmarks 3. Product that trades off the spread to our core products 4. Extending the eSpeed advantage to more new products

| Software Solutions | (sŏft wer' sə loo'shənz) n.

 The power of eSpeed's software and intellectual property
 Showcasing the extendibility

and scalability or our platform

3. The continued diversification of eSpeed's revenues through licensing our software and intellectual property to third parties.

\Innovative Technology\ (in'ə vā'tiv tek nŏl'ə jē) n.

- 1. Powers eSpeed's electronic marketplace to make trading faster, smarter and more efficient than ever
- **2.** (syn.) Synonymous with eSpeed

(e·Speed)

for the world's financial electronic marketplaces 2. transforming the way people trade in the fixed income markets 3. the preferred system for unrivaled liquidity and the best prices 4. (informal) volume, volume, volume

eSpeed is the definitive marketplace technology provider for the financial capital markets of the world. Simply defined, whether it's trading U.S. treasuries, European government bonds, interest rate swaps or foreign exchange—eSpeed is there

That's because we've succeeded in making financial markets better, faster and more efficient than ever before,

Our innovative technology and global distribution have made us the preferred trading tool of the world's leading financial institutions who rely on eSpeed to trade hundreds of billions of dollars on our system daily. They know that we deliver the technology and products that create the most liquid and efficient electronic marketplace imaginable, right to their desktops.

And that's just the beginning, eSpeed is already focused on transforming the next generation of the world's fixed income markets from voice to electronic trading—a universe close to five times the size of the world's stock markets.

Look ahead. You'll see the future of trading is clearly defined



wizh' en \ >>> n. 1. the power of anticipating that which will come to be 2. recognizing an opportunity to automate and transform an entire voice-brokered trading business 3. the ability to lead the evolution in electronic trading in the fixed income markets 4. focusing on the next great opportunity in trading

At its inception, the people at eSpeed had a vision: to create the world's most innovative and robust electronic marketplaces where traders would go to buy and sell a variety of fixed income products electronically. Since then, our relentless commitment to our customers, enhancements to out technology and developments in new markets have made us the definitive technology leader in the fixed income market globally.

Today, eSpeed lives at the heart of the global financial markets, where fixed-income securities intersect interest rate swaps, foreign exchange and a host of other products beyond equities.

We occupy the most valuable real estate in this space—the computer screen in front of the world's leading financial market traders. And eSpeed is there at the beginning, middle and end of each trade, commanding their attention.

When you comprehend our volume capacity and our power as a distribution mechanism, you will get a clear picture of where trading is going. And wherever it goes, eSpeed will be there.

grōwth

\g r \overline{0} t h \>>> n. 1. development from a simpler to more complex stage 2. leveraging one's core business for entrée into new areas 3. eSpeed's business goal

In 2002, eSpeed saw increasing volumes, increasing revenues and increasing profits. But we know what happens to companies that take those results for granted; that's why we're continuously transforming ourselves. It's not our nature to stand still.

And so, we continue to lead the migration of voice-traded financial markets to electronic trading. The commanding position eSpeed has already established in our core products, the global government bond markets, will serve as our foundation as we move into new products like foreign exchange, interest rate swaps and futures.

Our core technology is built and paid for. Adding and launching new products on the eSpeed system will cost us very little. Opportunities for growth are potentially enormous.

defining

strat·e·gy

\strat' a jē\>>> n. 1. a plan or method for obtaining specific results 2. our four-pronged plan to drive eSpeed's growth across the financial capital markets 3. leveraging our core business and technology to grow in additional financial markets

why will we succeed?

For several reasons. Today, eSpeed is the leader in electronic trading of global government bonds, a market with electronic revenue potential of \$725 million. Additionally, eSpeed is the leader in the U.S. treasury markets, the benchmark for the trading of all other U.S. interest rate products. The position we enjoy in our core markets is a significant advantage over competitors. And, we have a tremendous network to leverage. We plan to use this position to help us extend into other areas of electronic trading within the fixed income markets.

Our partnerships with the premier market makers and traders around the globe, combined with the fact that our software already resides on the desktops of thousands of traders around the world, leaves us poised for strategic growth and expansion in the financial capital markets. The following four growth drivers will help us get there...

Core Products\ eSpeed's plans are grounded in the wealth of experience we have in our core government bond markets. Huge as they are, these markets continue to grow and we're constantly improving our market position within them. We're enjoying growth on top of growth in the most fundamental part of our business.

These core markets have served as proving grounds, and our steady increase in fullyelectronic revenue year after year is a sure sign we are on the right path. These markets position us to extend our platform's reach and serve as a foundation for growth as we enter a new phase of converting and automating the \$4 billion inter-dealer wholesale voice brokerage market to fully electronic trading.

Product Extensions and Software Enhancements\ Finding ways to leverage our core market position is at the cornerstone of our product extension plan. With most of the global fixed income markets already trading in relation to or against our electronic government bond market benchmark prices, this plan will serve us well. We intend to repeat the successful business strategy we have used in the benchmark U.S. Treasury markets by focusing on these product extensions. Specifically, we will target electronic trading in off-therun treasuries, when-issued treasuries, treasury spreads and U.S. agencies—all products that trade off of a spread to our core U.S. Treasury products.

Additionally, by focusing on our software enhancements, we will continue to increase the value of our screen real estate at the center of the trader's desktop. SuperQuads, our new screen configuration, was released in the final quarter of 2002 as an important piece of our

growth strategy. It is designed to make the addition of new products seamless, inexpensive and simple for our end users. Through SuperQuads, traders can subscribe to multiple instruments in a variety of formats while simultaneously monitoring key elements, such as market depth and activity, for each.

Deeper into eSpeed's system, we've engineered software enhancements that go right to the heart of trading, encouraging buyers and sellers to make markets. Price Improvement is the latest incentive we've created. In a single keystroke, a trader can improve his or her price in order to get a deal done. Not surprisingly, traders have taken to it rapidly.

Direct Dealing, our version of "Request For Quote," is another software feature that illustrates how our electronic platform improves upon voice-based trading. With Direct Dealing, it's easy for a seller to go one-to-one with individual buyers or invite select market participants to submit a price quote. It's the perfect way to gauge interest in an offering or generate liquidity in markets that otherwise may be inactive.

\Product Rollouts In 2002, we began introducing revolutionary products and nurturing strategic partnerships that will bear fruit over the coming years. Our focus for these product rollouts is on the interest rate swap, futures and foreign exchange marketplaces.

Forming partnerships with major liquidity providers is one way we will successfully enter these new markets. Whether it is through agreements with global fixed income liquidity

providers for price feeds or for product distribution, eSpeed's partnerships will be the cornerstone of many of our product rollouts. Take for example our arrangement with the Chicago Board of Trade, announced in December 2002, for joint trading of U.S. treasury cash and futures products. It's a fantastic blueprint for building more win-win partnerships.

\Software Solutions\ Our system is unsurpassed and has proven its reliability; our desktop real estate is in the world's prime location, on the trader's desk; the intellectual property belongs to eSpeed; and we are only beginning to tap our network's potential. Welcome to our Software Solutions business.

The past year has been just a preview of the power of eSpeed's software and intellectual property. We license our software and intellectual property to third parties so they can build and run their own trading platforms, conduct auctions and issue debt. In 2002, we saw agreements with the Federal Home Loan Bank, the Chicago Mercantile Exchange, the Chicago Board of Trade and Intercontinental Exchange begin to define this area of growth for our company.

Our software solutions business, which capitalizes on the extendibility and scalability of our platform, diversifies our revenue sources by contributing multi-year subscription or licensing fees across a broad range of markets.

Our four-pronged strategy uniquely positions us for growth. Whether innovating with software, increasing volumes in our core markets, quickly building new liquid marketplaces or recognizing software licensing opportunities, eSpeed is clearly defining the future of electronic trading. We've experienced it before. Once markets move to electronic trading, there is no going back.

prog ress

\prog'res\>>> n. 1. movement toward a specific goal

2. cumulative improvement 3. forward or onward move-

ment in space or time 4. a rebuilt and redefined company

5. eSpeed in 2002





\dear shareholders\

We began 2002 expecting to spend the entire year rebuilding. It took us less than six months.

We finished the year redefining ourselves and are now well-positioned to define the future of electronic trading, as evidenced by our spectacular growth in 2002.

In January, little more than three months after the devastation of September 11, 2001, it was impossible to conceive how much would be achieved over the course of the year. What is truly remarkable is how this early momentum was quickly transformed into tangible growth. Our stellar results for the year demonstrate convincingly the strength, vision and passion of our team.

We're very proud to have finished the year as the 25th best performing stock on the NASDAQ. Four quarters of steadily increasing profits in this economy put us in a very small class of public companies. We began 2002 with the expectation of generating net operating earnings of between \$0.40-\$0.47 per basic share, or \$0.39-\$0.46 per diluted share, and ended the year reporting extraordinary results of \$0.57 per basic share, or \$0.55 per diluted share. On a GAAP basis, this translated into \$0.76 per basic share, or \$0.74 per diluted share, including non-operating income. Combine these results with our focus, commitment and drive and the magnitude of the achievement of the past twelve months is clear.

With our infrastructure rebuilt, we focused on growth in the second half of 2002—specifically in the areas of new product rollouts, product extensions and software enhancements. With our core government bond business serving as a solid foundation, we turned our efforts to the next generation of growth for eSpeed by identifying the products that trade most closely to our core business, and began developing and deploying software to meet the needs of traders in these new markets. Additionally, we completed the development of our Price Improvement software enhancement and our SuperQuads screen configuration and began to roll them out to the trading community.

2002 also saw the rebuilding of our Board of Directors and senior management. Bernie Weinstein, a founder and the former Chief Executive of ILX Systems, joined us to head our

Software Solutions business. In this role, he will leverage our global infrastructure, our electronic trading expertise and our portfolio of intellectual property to allow us to expand into new markets. Also in 2002, Jeffrey M. Chertoff became our Chief Financial Officer. His 26-year career in financial management and accounting will serve us well as we move ahead.

Finally in 2002, Albert M. Weis and John H. Dalton joined our Board of Directors. Mr. Weis is the former Chairman of the New York Board of Trade and the New York Cotton Exchange. His vast experience is of tremendous value as we set our sights on new markets and opportunities beyond our core products. Mr. Dalton, former Secretary of the U.S. Navy, former President of Ginnie Mae and current President of IPG Photonics, has brought his expert knowledge of the mortgage and banking sectors to our Board.

Throughout 2002, our consistent four-pronged strategy for growth yielded results. Our December arrangement with the Chicago Board of Trade to offer traders the world's largest combined cash and futures marketplace from a single location—the eSpeed system—showcases the significance of our desktop real estate, in front of traders of the world's leading financial institutions. This physical position, coupled with our global connectivity, is a major hurdle for potential competitors. The value of this asset—the world's prime location to roll out electronic financial products—will best be measured by its impact over the coming years.

The CBOT® agreement is made possible by our new SuperQuads screen, which we introduced

late in 2002. When combined with powerful new tools like Price Improvement and Direct

Dealing, our screen becomes the crossroads of the financial world-where multiple fixed

income instruments intersect and traders create and implement strategies that would other-

wise be difficult, if not impossible, to execute. The ease with which we are able to integrate

these various markets illustrates the power and flexibility of our hardware, software and cus-

tomer service.

eSpeed is on a steady course, and the key to our future is growth. In the course of 2003 and

beyond, we will expand our market opportunity from \$725 million to \$1.5 billion, bringing elec-

tronic trading to an ever-widening circle of global financial markets.

Our strong position today gives us every confidence for the future. eSpeed's vision is to suc-

cessfully automate the marketplaces for the financial world beyond stocks. We thank you

again for your continued support and belief in this vision.

Yours sincerely,

Howard W. Lutnick

Chairman, CEO and President

Lee M. Amaitis

Global Chief Operating Officer

per·form·ance

\perp per form' ans\>>> n. 1. the execution or accomplishment of work, acts or feats 2. a particular action, deed or proceeding 3. the manner of performing or functioning 4. the basis for running a strong and successful company

For the period from March 10,

\Selected Financial Data\ >>>

>> In the table below, we provide you with our selected historical financial data. We have prepared this statement of operations and statement of financial condition data using our consolidated financial statements for the years ended December 31, 2002, 2001 and 2000 and for the period from March 10, 1999 (date of commencement of operations) to December 31, 1999. The consolidated financial statements for these periods were audited by Deloitte & Touche LLP, independent auditors. The following selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" beginning on page 20 of our Annual Report and with our consolidated financial statements and the notes thereto beginning on page 32 of our Annual Report.

Statement of Operations Data

(in thousands, except per share data)

	Years e	commencement of operations) to		
	2002	2001	2000	December 31, 1999
Total revenues	\$139,238	\$124,969	\$ 91,027	\$ 34,661
Expenses:				
Compensation and employee benefits	36,499	53,437	53,963	21,502
Occupancy and equipment	24,863	29,549	21,561	10,293
Professional and consulting fees	5,658	10,568	13,036	5,149
Communications and client networks	6,336	8,109	4,589	3,355
Marketing	4,778	4,356	8,285	_
Administrative fees paid to related parties	9,134	9,798	6,524	1,662
Non-cash business partner securities ⁽¹⁾	2,059	1,223	32,041	_
Options granted to Cantor employees ⁽²⁾	_	_		2,850
Loss on unconsolidated investments ⁽³⁾	950	3,833		_
Provision for September 11, 2001 events ⁽⁴⁾	(1,201)	13,323		_
Other	7,717	8,569	9,684	2,649
Total expenses	96,793	142,765	149,683	47,460
Income (loss) before provision (benefit) for income taxes	42,445	(17,796)	(58,656)	(12,799)
Income tax provision (benefit)	479	531	406	(212)
Net income (loss)	\$ 41,966	\$ (18,327)	\$ (59,062)	\$(12,587)
Basic net income (loss) per share	\$ 0.76	\$ (0.34)	\$ (1.15)	\$ (0.28)
Fully diluted net income (loss) per share	\$ 0.74	\$ (0.34)	\$ (1.15)	\$ (0.28)

(continued)

Statement of Operations Data

(in thousands, except per share data)

	Years e	ended Decem	nber 31,	For the period from March 10, 1999 (date of commencement of operations) to
	2002	2001	2000	December 31, 1999
Basic weighted average shares of common stock outstanding	54,991	54,297	51,483	44,495
Fully diluted weighted average shares of common stock outstanding	56,784	54,297	51,483	44,495
Statement of Financial Condition Data (in thousands)				
		E	ecember 31,	
	2002	2001	2000	1999
Cash and cash equivalents	\$187,999	\$159,899	\$122,164	\$134,846
Total assets	252,711	210,741	157,034	188,672
Total liabilities	34,256	37,559	24,776	53,160
Total stockholders' equity	218,455	173,182	132,258	135,512

⁽¹⁾ See "Notes to Consolidated Financial Statements, Note 7."

⁽²⁾ Concurrent with the initial public offering, we issued 290,320 options to Cantor employees and a consultant. The estimated fair value of the options at the time of the offering resulted in a one-time non-cash charge to us of \$2,850.

⁽³⁾ See "Notes to Consolidated Financial Statements, Note 7."

⁽⁴⁾ See "Notes to Consolidated Financial Statements, Note 2."

\Management's Discussion\ and Analysis of Financial Condition and Results of Operations >>>

Overview

- > > > We were incorporated on June 3, 1999 as a Delaware corporation. Prior to our initial public offering, we were a wholly-owned subsidiary of, and we conducted our operations as a division of, Cantor Fitzgerald Securities, which in turn is a 99.5%-owned subsidiary of Cantor Fitzgerald, L.P. We commenced operations as a division of Cantor on March 10, 1999, the date the first fully electronic transaction using our eSpeed® system was executed. Cantor has been developing systems to promote fully electronic marketplaces since the early 1990s. Since January 1996, Cantor has used our eSpeed® system internally to conduct electronic trading.
- > > Concurrent with our initial public offering in December 1999, Cantor contributed to us, and we acquired from Cantor, certain of our assets. These assets primarily consisted of proprietary software, network distribution systems, technologies and other related contractual rights that comprise our eSpeed® system.
- > > On September 11, 2001, our principal place of business at One World Trade Center was destroyed and, as a result, we lost 180 employees and Cantor and TradeSpark lost 478 employees. Through implementation of our business recovery plan, we immediately relocated our surviving employees to various locations in the New York metropolitan area. Our operating proprietary software was unharmed.
- > > As of December 31, 2002, we had an accumulated deficit of \$49.4 million. This loss primarily resulted from expenditures on our technology and infrastructure incurred in building our revenue base and from non-cash charges incurred in connection with the issuance of business partner securities. In spite of the September 11 Events, for the year ended December 31, 2002, we recorded annual net income for the first time. We expect that we will continue to generate net income from operations. However, in light of the rapidly changing nature of our business and the impact of the

September 11 Events, we believe that period-to-period comparisons of our operating results will not necessarily be meaningful and should not be relied upon as an indication of future performance.

- > > > We operate interactive electronic marketplaces and license customized real-time software solutions to our clients. In general, we receive transaction fees based on a percentage of the face value of products traded through our system. Products may be traded on a fully electronic basis, electronically through a voice broker, or via open outcry with prices displayed on data screens. We receive different fees for these different system utilizations. Additionally, we receive revenues from licensing software and providing technology support.
- >>> We have entered into an Amended and Restated Joint Services Agreement with Cantor under which we and Cantor have agreed to collaborate to provide brokerage and related services to clients in multiple electronic markets for transactions in securities and other products. Under the Amended and Restated Joint Services Agreement, as currently in effect, we are responsible for providing electronic brokerage services, and Cantor provides voice-assisted brokerage services, fulfillment services, such as clearance and settlement, and related services, such as credit risk management services, oversight of client suitability and regulatory compliance, sales positioning of products and other services customary to marketplace intermediary operations. Under this agreement, we and Cantor share revenues derived from transactions effected in the marketplaces in which we collaborate and other specified markets. The portion of the transaction revenues that we and Cantor receive are based on several factors, including whether: (1) the marketplace is one in which we collaborate with Cantor; (2) the transaction is fully electronic or Cantor provides voice-assisted brokerage services; (3) the product traded is a financial or other product; and (4) the product

is traded on the Cantor ExchangeSM. The percentage of the transaction revenues we receive ranges from 2.5% to 65%. However, in general, for fully electronic transactions, we receive 65% of the transaction revenues and Cantor receives 35% of the transaction revenues; and for voice-assisted brokerage transactions, Cantor receives 93% of the transaction revenues and we receive 7% of the transaction revenues. In addition, if the transactions relate to a gaming business, we receive 25% of the net trading revenues. We have agreed to provide to Cantor technology support services at cost.

> > We have also entered into services agreements with TradeSpark, Freedom, Municipal Partners LLC (MPLLC) and CO2e.com (CO2e) pursuant to which we provide the technology infrastructure for the transactional and technology related elements of the TradeSpark, Freedom, MPLLC and CO2e marketplaces, as well as certain other services, in exchange for specified percentages of transaction revenues from the marketplaces. In general, if a transaction is fully electronic, we receive 65% of the aggregate transaction revenues and TradeSpark or Freedom receives 35% of the transaction revenues. If TradeSpark or Freedom provides voice-assisted brokerage services with respect to a transaction, then we receive 35% of the revenues and TradeSpark or Freedom receives 65% of the revenues. We and MPLLC each receive 50% of the fully electronic revenues related to municipal bonds. Our agreement with CO2e provides that we receive 50% of CO2e's fully electronic revenues and 15% of CO2e's voice-assisted and open outcry revenues until December 2003; thereafter we will receive 20% of voice-assisted and open outcry revenues.

>>> We have pursued an aggressive strategy to convert most of Cantor's fixed income marketplace products to our eSpeed® system and, with the assistance of Cantor, to continue to create new markets and convert new clients to our eSpeed® system. The process of converting these marketplaces includes modifying existing trading systems to allow for transactions to be entered directly from a client location, signing an agreement with the client, installing the hardware and software at the client location and establishing communication lines between us and the client. Other than Cantor, no client of ours accounted for more than 10% of our transaction revenues from our date of inception through December 31, 2002. As a result of the September 11 Events and the resulting loss of voice brokers, Cantor's U.S. operations were reduced, including the trading by it of certain U.S. financial products. Cantor also sold the assets of its municipal bond business in the first guarter of 2002 after that business ceased operations on September 11, 2001, but acquired a 25% special interest in MPLLC, the newly formed entity that owns the assets. Cantor has not yet fully determined which financial product marketplaces it will re-enter. In addition, Cantor's business product development activity continues to be reduced due to the September 11 Events. If Cantor determines not to re-enter its affected businesses, exits additional businesses or does not continue to develop new products or enter into new businesses, we will likely be adversely affected.

Critical Accounting Policies and Estimates

> > The following discussion is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments which affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosures of contingent assets and liabilities. Actual results may differ from our estimates as a result of the occurrence of future events or changes in conditions which affected our judgments or estimates.

- > > We believe that the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.
- > > Provision for September 11 Events: We recorded an expense of \$13.3 million in the year ended December 31, 2001 for the costs which we had incurred or expected to incur and for assets which were destroyed or impaired as a result of the September 11 Events. Due to the extent of the loss of life and the destruction of assets, the effect of the September 11 Events required us to make estimates and judgments in an uncertain environment. In our judgment, such costs were properly recorded in the same period as the September 11 Events, even if disbursement did not occur until future periods. During the year ended December 31, 2002, actual costs incurred were charged against the provision and the remaining unused amount was reversed in the fourth guarter of 2002.
- >> Insurance Coverage: We have insurance coverage for both property and casualty losses and for business interruption through our Administrative Services Agreement with Cantor.
- > > During 2002, we received and recognized as income \$12,832,886 of the \$40,000,000 business interruption insurance recovery received by Cantor. This allocation was based on an analysis prepared by an independent consultant.
- > > Under the property and casualty coverage of \$40 million, we expect to be reimbursed through Cantor for the greater of fair value or replacement costs for assets lost as a result of the September 11 Events. To the extent that the cost of assets replaced exceeds the carrying value of the assets destroyed, we will recognize a gain on replacement of assets resulting from potential additional recoveries under our property and casualty coverage. However, we cannot currently estimate the amount or timing of any such gain, if any, and accordingly, no gains on replacement of fixed assets have been recorded during the current year.

- > > Related Party Transactions: As described above, we share revenues with Cantor, TradeSpark, Freedom, MPLLC and CO2e. In addition, we provide technology support services to Cantor, TradeSpark, Freedom, MPLLC and CO2e, and Cantor provides administrative services to us.
- >> Since Cantor holds a controlling interest in us, and holds a significant interest in TradeSpark and Freedom, such transactions among and between us and Cantor, TradeSpark and Freedom are on a basis which 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 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.
- > > Patents: We capitalized the costs associated with the purchase of two patents acquired in 2001. In order to perfect and defend our rights under the patents, we have incurred substantial legal costs. We have capitalized such legal costs, thereby increasing the carrying value of the patents. These capitalized costs, and the original purchase price of the patents, are amortized over the remaining life of the patent to which they relate, and are reflected net of accumulated amortization as an asset in our statements of financial condition. 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 if the patents do not provide the competitive advantages which we anticipated at the time of purchase, we may have to writedown the patents, and such charges could be substantial.

- >>> Capitalized Software Costs: We capitalize, in accordance with Generally Accepted Accounting Principles (GAAP), the direct costs of employees who are engaged in creating software for internal use. This treatment requires us to estimate the portion of the employees' efforts which directly produce new software or provide additional functionality to existing software.
- > > In our judgment, these employee-related costs serve to create or enhance valuable software. Our current policy is to capitalize these costs and amortize them over their estimated economic useful life of three years on a straight-line basis. However, if the costs incurred to produce the software are ultimately deemed to exceed the benefit which the software provides, we may have to write-down the capitalized software costs, and such charge could be substantial.
- > > Business Partner Securities: We enter into transactions with business partners in which we issue certain equity instruments whose value, in part, is dependent on the value of our publicly traded Class A common stock. Such business partner securities include options and warrants to purchase shares of our Class A common stock as

well as convertible preferred shares. The preferred shares are convertible into either shares of our Class A common stock or warrants to purchase shares of our Class A common stock.

- > > The value of these business partner securities issued establishes either the basis of assets acquired in exchange for the instruments, or an expense which is, or will be, recognized in conjunction with the issuance.
- >>> We utilize judgment in establishing the fair value of these business partner securities in the absence of a ready market for such instruments. Options and warrants are valued using an option pricing model which requires us to make assumptions as to future interest rates, price volatility of our Class A common stock, future dividends and the expected life of the option or warrant being valued. We believe that our assumptions used in the valuation of the instruments are reasonable. However, changes in the assumptions could result in differing valuations of the options, warrants or preferred shares which, in turn, would change the basis of assets acquired or expense recognized.

Results of Operations

Revenues

	Year ended December 31, 2002	Percentage of total revenues	Year ended December 31, 2001	Percentage of total revenues	Year ended December 31, 2000	Percentage of total revenues
	(in thousands)		(in thousands)		(in thousands)	
Transaction revenues with related parties						
Fully electronic transactions	\$ 88,039	63.3%	\$ 75,430	60.4%	\$52,693	57.9%
Voice-assisted brokerage transactions	17,552	12.6	22,553	18.1	15,144	16.6
Screen-assisted open outcry transactions	190	0.1	385	0.3	2,450	2.7
Total transaction revenues with						
related parties	105,781	76.0	98,368	78.8	70,287	77.2
Software Solutions fees from						
related parties	13,207	9.5	16,283	13.0	12,333	13.5
Software Solutions and licensing fees						
from unrelated parties	4,512	3.2	1,962	1.6	66	0.1
Business interruption insurance proceeds	12,833	9.2	_	0.0	_	0.0
Gain on replacement of assets	_	0.0	2,680	2.1	_	0.0
Interest income from related parties	2,905	2.1	5,676	4.5	8,341	9.2
Total revenues	\$139,238	100.0%	\$124,969	100.0%	\$91,027	100.0%

Revenues—Comparison of the Years Ended December 31, 2002 and 2001

>>> Transaction Revenues with Related Parties:

For the year ended December 31, 2002, we earned \$105.8 million in transaction revenues with related parties, an 8% increase over transaction revenues with related parties of \$98.4 million for the year ended December 31, 2001. For the year ended December 31, 2002, 83% of our transaction revenues were generated from fully electronic transactions.

>> Our revenues are currently highly dependent on transaction volume in the fixed income markets globally. Accordingly, among other things, equity 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 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 Cantor. Consequently, our revenues have been negatively affected by the effect of the September 11 Events on Cantor and may continue to be negatively affected in the future if Cantor's business continues to suffer due to the September 11 Events or otherwise.

>> Software Solutions Fees from Related

Parties: Software Solutions fees from related parties for the year ended December 31, 2002 were \$13.2 million as compared to Software Solutions fees from related parties for the year ended December 31, 2001 of \$16.3 million, a decrease of 19%. Software Solutions fees from related parties decreased primarily as a result of a decrease in support provided to Cantor and TradeSpark due to the loss of

their voice brokers as a result of the September 11 Events. This decrease was offset in part by additional Software Solutions fees from MPLLC, which began utilizing our systems in 2002.

>>> Software Solutions and Licensing Fees from Unrelated Parties: Software Solutions and licensing fees from unrelated parties for the year ended December 31, 2002 were \$4.5 million as compared with \$2.0 million for the year ended December 31, 2001, an increase of 125%, due primarily to licensing fees earned in 2002 from InterContinentalExchange for use of the Wagner Patent and licensing fees earned as part of the Wagner Patent Settlement Agreement, as more fully described in Note 4 of our consolidated financial statements. We anticipate that as we license our software and patents to additional market participants, our revenues from Software Solutions and licensing fees from unrelated parties will continue to grow.

> > Business Interruption Insurance Proceeds:

During the year ended December 31, 2002, we received and recognized as revenue \$12.8 million as our portion of the \$40 million business interruption insurance recovery received by Cantor. This allocation was based on an analysis prepared by an independent consultant.

>>> Gain on Replacement of Assets: Our assets in the World Trade Center were destroyed as a result of the September 11 Events. Such assets were covered by insurance policies which provide for reimbursement for replacement cost if such destroyed assets are replaced. To the extent that replacement cost exceeds the carrying value of such replaced equipment, the excess results in a gain. For the year ended December 31, 2001, we recognized \$2.7 million of such gains. No additional proceeds were received in 2002 and, accordingly, no gains were recognized in 2002.

(continued)

>> Interest Income from Related Parties: For the year ended December 31, 2002, we generated interest income from overnight reverse repurchase agreements with a related party of \$2.9 million as compared to interest income of \$5.7 million for the year ended December 31, 2001. The reduction in interest income was principally as a result of a reduction in weighted average interest rates on overnight reverse repurchase agreements from 3.9% in 2001 to 1.7% in 2002.

Revenues—Comparison of the Years Ended December 31, 2001 and 2000

>>> Transaction Revenues with Related Parties:

For the year ended December 31, 2001, we earned \$98.4 million in transaction revenues with related parties, a 40% increase over transaction revenues with related parties of \$70.3 million for the year ended December 31, 2000. The growth in these revenues was attributable to the roll out of electronic marketplaces and an increase in the number of clients electronically trading through our eSpeed® system.

>> > As a result of the September 11 Events, the United States government bond markets were closed on September 11th and September 12th. By the time the United States government bond markets reopened on September 13th, we had re-established global connectivity of our electronic trading system. Our transaction revenues for the three months after the September 11 Events represented 23% of our total transaction revenues for the 2001 calendar year. In addition, our transaction revenues from fully electronic transactions as a percent of total transaction revenues remained almost unchanged when comparing the three months after September 11th (77%) to the nine months ended September 30, 2001 (75%).

>> Software Solutions Fees from Related

Parties: Software Solutions fees from related parties for the year ended December 31, 2001 were \$16.3 million as compared to Software Solutions fees from related parties for the year ended December 31, 2000 of \$12.3 million, an increase of 33%. Software Solutions fees from related parties increased primarily as a result of an increase in support provided to Cantor as well as support provided to TradeSpark and Freedom prior to the September 11 Events.

>> Software Solutions Fees from Unrelated Parties: Software Solutions fees from unrelated parties for the year ended December 31, 2001 were \$2.0 million as compared with \$0.1 million for the year ended December 31, 2000. This increase resulted from the addition of new clients and a full year of revenue for clients added during 2000.

> > Gain on Replacement of Assets: For the year ended December 31, 2001, we recognized \$2.7 million of such gains. See further discussion in the 2002 to 2001 comparison.

>>> Interest Income from Related Parties: For the year ended December 31, 2001, we generated interest income from overnight reverse repurchase agreements with a related party of \$5.7 million, as compared to interest income of \$8.3 million for the year ended December 31, 2000. The reduction in interest income was principally a result of a reduction in weighted average interest rates on overnight reverse repurchase agreements from 6.3% in 2000 to 3.9% in 2001, offset in part by interest on the proceeds of our follow-on public offering in March 2001.

Expenses

	Year ended	Percentage	Year ended	Percentage	Year ended	Percentage
	December 31,	of total	December 31,	of total	December 31,	of total
	2002	revenues	2001	revenues	2000	revenues
	(in thousands)		(in thousands)		(in thousands)	
Compensation and employee benefits	\$36,499	37.7%	\$ 53,437	37.4%	\$ 53,963	36.1%
Occupancy and equipment	24,863	25.7	29,549	20.7	21,561	14.4
Professional and consulting fees	5,658	5.9	10,568	7.4	13,036	8.7
Communications and client networks	6,336	6.6	8,109	5.7	4,589	3.1
Marketing	4,778	4.9	4,356	3.1	8,285	5.5
Administrative fees paid to related parties	9,134	9.4	9,798	6.9	6,524	4.4
Non-cash business partner securities	2,059	2.1	1,223	0.9	32,041	21.4
Loss on unconsolidated investments	950	0.9	3,834	2.7	0	0.0
Provision for September 11 Events	(1,201)	(1.2)	13,323	9.3	0	0.0
Other	7,717	8.0	8,569	5.9	9,684	6.4
Total expenses	\$96,793	100.0%	\$142,766	100.0%	\$149,683	100.0%

Expenses—Comparison of the Years Ended December 31, 2002 and 2001

> > Compensation and Employee Benefits: At December 31, 2002, we had 319 employees, which was a slight increase from the 312 employees we had at December 31, 2001. However, prior to the September 11 Events, we had 492 employees. For the year ended December 31, 2002, our compensation costs were \$36.5 million as compared to compensation costs of \$53.4 million for the year ended December 31, 2001. This decrease in compensation costs and in the number of employees was principally due to the September 11 Events.

> > 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. We expect that our future compensation costs will increase depending, in part, upon a variety of factors, including our incremental revenue growth.

> > Occupancy and Equipment: Occupancy and equipment costs were \$24.9 million for the year ended December 31, 2002, a decrease of 16% as compared to occupancy and equipment costs of \$29.5 million for the year ended December 31, 2001. The decrease was primarily

caused by our reduced need for office space as a result of the September 11 Events.

> > Occupancy expenditures primarily consist of the rent and facilities costs of our offices in the New York metropolitan area and our offices in London and Tokyo. We moved into our temporary corporate headquarters in New York City during the second quarter of 2002. The lease for our temporary headquarters will expire in February 2004, and at this time management is evaluating various location alternatives. We anticipate that our occupancy costs will remain substantially unchanged in 2003. Although we also believe that equipment costs will increase in the future as we replace lost equipment, we anticipate that such equipment costs will remain below those incurred prior to the September 11 Events. We expect a portion of our capital expenditures to be covered by insurance proceeds from our property and casualty insurance coverage.

> > Professional and Consulting Fees: Professional and consulting fees were \$5.7 million for the year ended December 31, 2002 as compared to professional and consulting fees of \$10.6 million for the year ended December 31, 2001, a decrease of 46%, primarily related to a decrease in contract personnel costs. We expect that professional and consulting fees will remain at a level consistent with the current full year amount.

> > The costs of professionals and consultants utilized to temporarily replace employees lost as a result of the September 11 Events are included in Provision for September 11 Events and, as a result, do not affect this expense caption.

> > Communications and Client Networks: Communications costs were \$6.3 million for the year ended December 31, 2002 as compared to \$8.1 million for the year ended December 31, 2001, a 22% decrease. The decrease was principally due to decreased data and telephone costs subsequent to the September 11 Events. Communication costs include the costs of local and wide area network infrastructure, the cost of establishing the client network linking clients to us, data and telephone lines, data and telephone usage, and other related costs. We anticipate expenditures for communications and client networks will increase in the near future as we continue to connect additional customers to our network.

> > Marketing: We incurred marketing expenses of \$4.8 million for the year ended December 31, 2002 as compared to marketing expenses during the year ended December 31, 2001 of \$4.4 million, an increase of 9%, resulting from the development of a 2002 advertising campaign. We expect our future marketing expenses to decrease as we reduce spending related to our advertising campaign.

>> Administrative Fees Paid to Related Par-

ties: Under an Administrative Services Agreement, Cantor provides various administrative services to us, including accounting, tax, legal and facilities management, for which we reimburse Cantor for the direct and indirect costs of providing such services. Administrative fees paid to related parties amounted to \$9.1 million for the year ended December 31, 2002, a 7% decrease over the \$9.8 million of such fees for the year ended December 31, 2001. Overall, administrative fees decreased in the months following the September 11 Events as compared to the months prior to the September 11 Events. We expect that the level of future administrative fees paid to related parties may increase in 2003.

> > Administrative fees paid to related parties are dependent upon both the costs incurred by Cantor and the portion of Cantor's administrative services that are utilized by us.

>>> Non-Cash Business Partner 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. Non-cash business partner securities charges were \$2.1 million for the year ended December 31, 2002, an increase of 75% as compared to non-cash business partner securities charges of \$1.2 million for the year ended December 31, 2001. This increase resulted from a full year of amortization on warrants that were issued under agreements with two business partners during 2001. Amortization on warrants issued under an agreement executed with a business partner in August of 2002 further contributed to this increase. We believe period to period comparisons are not meaningful as these transactions do not recur on a regular basis. Note 7 of our consolidated financial statements in this Report and on Form 10-K contains further details regarding the issuance by us of noncash business partner securities.

>>> Loss on Unconsolidated Investments: As discussed in Note 7 of our consolidated financial statements, we wrote down our investment in Tradespark by \$950,000 to its net realizable value in the fourth quarter of 2002 based on the results of an annual assessment required under GAAP.

>> Provision for September 11 Events: As described in Note 2 of our consolidated financial statements, we recorded an expense of \$13.3 million in the year ended December 31, 2001 to reflect our estimate of the costs incurred or expected to be incurred and assets impaired as a direct result of the September 11 Events. For the year

ended December 31, 2002, the remaining accrual related to the September 11 Events of \$1,200,507 was reversed.

> > Other: Other expenses consist primarily of recruitment fees, travel, promotional and entertainment expenditures. For the year ended December 31, 2002, other expenses were \$7.7 million, a decrease of 10% as compared to other expenses of \$8.6 million for the year ended December 31, 2001. The decrease resulted primarily from the decrease in recruitment fees. We anticipate that other expenses will increase in the future, primarily due to an increase in business related insurance expenses.

>>> Provision for Income Taxes: Income taxes through 2002 have been minimal due to the benefit of the NOL carry forward. We expect the remaining NOL carry forward will be fully utilized during 2003 and subsequent to that, we, will begin to record income tax provisions at an anticipated effective tax rate of less than 40%.

Expenses—Comparison of the Years Ended December 31, 2001 and 2000

> > Compensation and Employee Benefits: At December 31, 2001, we had 312 professionals. Immediately prior to the September 11 Events, we had 492 professionals, as compared to 493 at December 31, 2000. For the year ended December 31, 2001, our compensation costs were \$53.4 million as compared to compensation costs of \$54.0 million for the year ended December 31, 2000. Our quarterly compensation costs after the September 11 Events reflected a 50% reduction as compared to the three months ended September 30, 2001.

> > Occupancy and Equipment: Occupancy and equipment costs were \$29.5 million for the year ended December 31, 2001, an increase of 37% as compared to occupancy and equipment costs of \$21.6 million for the year ended December 31, 2000. The net increase in occupancy and equipment costs was due to the expansion of space needed to accommodate our additional operations and an

increase in the number of our locations, including our new concurrent computing center in New Jersey, offset in part by reduced rent expense following the destruction of One World Trade Center.

>> Professional and Consulting Fees: Professional and consulting fees were \$10.6 million for the year ended December 31, 2001 as compared to professional and consulting fees of \$13.0 million for the year ended December 31, 2000, a decrease of 18%, primarily related to a decrease in contract personnel costs prior to September 11th.

>>> Communications and Client Networks: Communications costs were \$8.1 million for the year ended December 31, 2001 as compared to \$4.6 million for the year ended December 31, 2000, a 76% increase. Communication costs include the costs of local and wide area network infrastructure, the cost of establishing the client network linking clients to us, data and telephone lines, data and telephone usage, and other related costs. The increase in costs was attributable to the expansion of our globally managed digital network.

> > Marketing: We incurred marketing expenses of \$4.3 million for the year ended December 31, 2001, a 48% decrease as compared to marketing expenses of \$8.3 million for the year ended December 31, 2000. Marketing expenses were higher in 2000 due to the implementation of our marketing program in that year. In addition, marketing expenditures sharply declined in the quarter following the September 11 Events.

> > Administrative Fees Paid to Related Parties:

Administrative fees paid to related parties are dependent upon both the costs incurred by Cantor, and the portion of Cantor's administrative services which is utilized by us.

>> Non-Cash Business Partner 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. We believe period to period comparisons are not meaningful as these transactions do not recur on a regular basis. Note 7 of our consolidated financial statements in this Report and on Form 10-K contains further details regarding the issuance by us of non-cash business partner securities.

> > Loss on Unconsolidated Investments: In the third quarter of 2001, we wrote off our investments in QV Trading Systems and Visible Markets, each of which ceased operations during that period. We recognized a loss of \$3.8 million related to such write-offs.

>> Provision for September 11 Events: As described in Note 2 of our consolidated financial statements, we recorded an expense of \$13.3 million in the year ended December 31, 2001 to reflect our estimate of the costs incurred as a direct result of the September 11 Events. Of these costs, \$6.2 million represented write-offs of software development costs and goodwill and, as such, did not require cash outlays.

> > Other: Other expenses consist primarily of recruitment fees, travel, promotional and entertainment expenditures. For the year ended December 31, 2001, other expenses were \$8.6 million, a decrease of 11% as compared to other expenses of \$9.7 million for the year ended December 31, 2000. The decrease resulted primarily from the decrease in recruitment fees.

Quarterly Results of Operations

>> The following table sets forth, by quarter, statement of operations data for the period from January 1, 2001 to December 31, 2002. Results of any period are not necessarily indicative of results for a full year.

	2002 Quarter Ended				
	March 31	June 30	September 30	December 31	
Total revenues Total expenses	\$30,033,175 24,063,057	\$43,449,094 23,643,686	\$ 32,978,651 25,190,762	\$32,777,091 23,895,587	
Income before provision for income taxes Income tax provision	5,970,118 114,000	19,805,408 114,000	7,787,889 122,065	8,881,504 128,502	
Net income	\$ 5,856,118	\$19,691,408	\$ 7,665,824	\$ 8,753,002	
Fully diluted net income per share	\$ 0.10	\$ 0.35	\$ 0.14	\$ 0.15	
	2001 Quarter Ended				
	March 31	June 30	September 30	December 31	
Total revenues Total expenses	\$31,887,574 34,080,038	\$34,079,474 34,892,678	\$ 28,191,333 50,912,728	\$30,810,433 22,879,322	
Income (loss) before provision for income taxes Income tax provision	(2,192,464) 99,999	(813,204) 158,001	(22,721,395) 129,000	7,931,111 144,000	
Net income (loss)	\$ (2,292,463)	\$ (971,205)	\$(22,850,395)	\$ 7,787,111	
Fully diluted net income (loss) per share	\$ (0.04)	\$ (0.02)	\$ (0.42)	\$ 0.14	

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. During the fourth quarter of 2002, the timing of the holidays contributed to a slowdown in transaction volume. However, the anticipated year-end slowdown did not occur as dramatically in 2001 because of the volatility in the global markets.

Liquidity and Capital Resources

- > > At December 31, 2002, we had cash and cash equivalents of \$188.0 million. We generated cash in 2002 of \$60.6 million from our operating activities, consisting almost entirely of net income after non-cash items of \$60.0 million. We also used net cash for investing activities in 2002 of \$33.7 million resulting from purchases of fixed assets, capitalization of software development costs and patent defense costs.
- > > As of December 31, 2002, we had repurchased 24,600 shares of our Class A common stock for a total of \$221,892 under the repurchase plan authorized by our board of directors. Our board has authorized the repurchase of up to \$40 million of our outstanding Class A common stock. During the first quarter of 2003, we purchased an additional 161,799 shares for a total purchase price of \$1,872,112, bringing the total number of treasury shares owned to 186,399 at a book value of \$2,094,004. We anticipate making additional stock repurchases in 2003.
- > > Our operating cash flows consist of transaction revenues from related parties 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 from related parties. 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 Amended and Restated Joint Services Agreement, remits the amount owed to us. In addition, we have entered into similar services agreements with TradeSpark, Freedom, MPLLC and CO2e. Under the Administrative Services Agreement, the Amended and Restated Joint Services Agreement and the services agreements with TradeSpark, Freedom, MPLLC and CO2e any net receivable or payable is settled at the discretion of the parties.

- > > > We anticipate that we will experience an increase in our capital expenditures and lease commitments consistent with our anticipated growth in operations, infrastructure, personnel, and our anticipated move into a new headquarters. We currently anticipate that we will continue to experience growth in our operating expenses for the foreseeable future and that our operating expenses will be a material use of our cash resources. Our property and casualty insurance coverage may mitigate our capital expenditures for the near term.
- > > Under the current operating structure, our cash flows from operations and our other cash resources should be sufficient to fund our current working capital and current capital expenditure requirements for at least the next 12 months. We do not currently have outside bank funding. 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, strategic alliances and joint ventures potentially involving all types and combinations of equity, debt, acquisition, recapitalization and reorganization alternatives. We are continually considering such options and their effect on our liquidity and capital resources.

(continued)

Quantitative and Qualitative Disclosures About Market Risk

> > At December 31, 2002, we had invested \$186.7 million of our cash in securities purchased under reverse repurchase agreements which are fully collateralized by U.S. Government securities held in a custodial account at JP Morgan Chase. These reverse repurchase agreements have an overnight maturity and, as such, are highly liquid. We generally do not use derivative financial instruments, derivative commodity instruments or other market risk sensitive instruments, positions or transactions. Accordingly, we believe that we are not subject to any material risks arising from changes in interest rates, foreign currency exchange rates, commodity prices, equity prices or other market changes that affect market risk sensitive instruments. Our policy is to invest our cash in a manner that provides us with the appropriate level of liquidity.

This Annual Report, including the Letter to Shareholders, contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors that are discussed under "Risk Factors" and elsewhere in our Form 10-K filed with the Securities and Exchange Commission.

Consolidated Statements of \Financial Condition\ >>>

As of December 31, 2002 and 2001

	December 31, 2002	December 31, 2001
Assets		
Cash	\$ 1,313,190	\$ 2,567,932
Reverse repurchase agreements with related parties	186,685,709	157,330,676
Total cash and cash equivalents	187,998,899	159,898,608
Fixed assets, net	26,383,590	19,137,269
Investments	11,174,718	11,732,863
Intangible assets, net	19,527,505	9,122,491
Receivable from related parties	5,266,445	7,641,441
Other assets	2,359,718	3,207,832
Total assets	\$252,710,875	\$210,740,504
Liabilities and Stockholders' Equity Liabilities:		
Payable to related parties	\$ 18,857,071	\$ 14,463,604
Accounts payable and accrued liabilities	15,398,757	23,095,092
Total liabilities	34,255,828	37,558,696
Stockholders' Equity:		
Preferred stock, par value \$0.01 per share; 50,000,000 shares authorized,		
8,000,750 shares issued and outstanding	80,008	80,008
Class A common stock, par value \$.01 per share; 200,000,000 shares authorized;		
29,783,682 and 26,590,668 shares issued	297,837	265,906
Class B common stock, par value \$.01 per share; 100,000,000 shares authorized;		
25,388,814 and 28,354,737 shares issued and outstanding	253,888	283,547
Additional paid-in capital	268,900,204	266,791,989
Unamortized expense of business partner securities	(1,495,500)	(2,691,900)
Treasury stock, 24,600 shares of Class A common stock at cost	(221,892)	(221,892)
Accumulated deficit	(49,359,498)	(91,325,850)
Total stockholders' equity	218,455,047	173,181,808
Total liabilities and stockholders' equity	\$252,710,875	\$210,740,504

See notes to the consolidated financial statements.

Consolidated Statements of \Operations\ >>>

For the years ended December 31, 2002, 2001 and 2000

	For the year ended December 31, 2002	For the year			year ended er 31, 2000	
Revenues:						
Transaction revenues with related parties						
Fully electronic transactions	\$ 88,039,301	\$ 75	5,429,874	\$ 52,692,703		
Voice-assisted brokerage transactions	17,551,873	22	2,553,037		15,144,343	
Screen-assisted open outcry transactions	190,321		385,115		2,450,333	
Total transaction revenues with related parties	105,781,495	98	3,368,026	-	70,287,379	
Software Solutions fees from related parties	13,206,987	16	6,283,305	•	12,333,222	
Software Solutions and licensing fees from						
unrelated parties	4,512,063	1	1,961,589		65,625	
Business interruption insurance proceeds						
from parent	12,832,886		_		_	
Gain on replacement of fixed assets	_		2,680,000		_	
Interest income from related parties	2,904,580		5,675,894		8,340,815	
Total revenues	139,238,011	124	1,968,814	(91,027,041	
Expenses:						
Compensation and employee benefits	36,498,880	53	3,437,250	53,963,239		
Occupancy and equipment	24,862,758	29	29,549,068		21,560,535	
Professional and consulting fees	5,657,752	10	10,568,007		13,036,494	
Communications and client networks	6,335,606	3	8,108,618		4,588,626	
Marketing	4,778,092	4	4,355,661		8,285,385	
Administrative fees paid to related parties	9,134,016	9,797,996		6,524,34		
Non-cash business partner securities	2,059,099	1	1,222,631	3	32,040,505	
Loss on unconsolidated investments	950,000	3	3,833,679		_	
Provision for September 11 Events	(1,200,507)	13,323,189			_	
Other	7,717,396	8	3,568,667	9,683,776		
Total expenses	96,793,092	142	2,764,766	14	19,682,901	
Income (loss) before provision for income taxes	\$ 42,444,919	\$ (17	7,795,952)	\$ (!	58,655,860)	
Provision for income taxes	478,567		531,000		406,125	
Net income (loss)	\$ 41,966,352	\$ (18	3,326,952)	\$ (5	59,061,985)	
Per share data:						
Basic net income (loss) per share	\$ 0.76	\$	(0.34)	\$	(1.15)	
Fully diluted net income (loss) per share	\$ 0.74	\$	(0.34)	\$	(1.15)	
Basic weighted average shares of						
common stock outstanding	54,991,400 54,296,81		1,296,811		51,482,505	
Fully diluted weighted average shares of						
common stock outstanding	56,784,436	54	1,296,811	Ę	51,482,505	

See notes to the consolidated financial statements.

Consolidated Statements of \Cash Flows\ >>>

For the years ended December 31, 2002, 2001 and 2000

	For the year ended December 31, 2002	For the year ended December 31, 2001	For the year ended December 31, 2000
Cash flows from operating activities:			
Net income (loss)	\$ 41,966,352	\$(18,326,952)	\$(59,061,985)
Adjustments to reconcile net income to net cash			
provided by operating activities:			
Depreciation and amortization	16,012,981	5,975,471	6,098,754
Issuance of non-cash business partner securities	2,059,099	1,222,631	32,040,505
Equity in net losses of certain unconsolidated			
investments	189,568	147,838	_
Loss on unconsolidated investments	950,000	3,833,679	_
Non-cash issuance of securities under employee			
benefit plans	52,210	440,679	_
Gain on replacement of fixed assets	_	(2,680,000)	_
Provision for September 11 Events, net	(1,200,507)	13,323,189	_
(Increase) decrease in operating assets:			
Other assets	266,686	475,675	(3,672,012)
Receivable from related parties, net	2,374,996	(5,729,738)	42,433,200
Increase (decrease) in operating liabilities:			
Payable to related parties, net	4,393,467	1,181,653	(37,806,881)
Accounts payable and accrued liabilities	(6,495,828)	3,762,327	9,422,915
Net cash provided by (used in) operating activities	60,569,024	3,626,452	(10,545,504)
Cash flows from investing activities:			
Purchases of fixed assets	(11,216,785)	(12,901,831)	(11,043,479)
Capitalization of software development costs	(8,705,840)	(7,358,226)	(9,026,568)
Purchase of patents	_	(2,650,000)	_
Capitalization of patent defense costs	(13,741,691)	(6,283,142)	_
Insurance claim proceeds resulting from destruction			
of fixed assets	_	20,476,420	_
Purchases of investments	_	(2,909,786)	(5,833,679)
Cash payment for TreasuryConnect LLC	_	(170,781)	_
Net cash used in investing activities	(33,664,316)	(11,797,346)	(25,903,726)

(continued)

(continued)

	For the year ended December 31, 2002		year ended per 31, 2001	For the year ended December 31, 2000
Cash flows from financing activities:				
Proceeds from issuances of securities	s —	\$	47,750,000	\$ 50,000,000
Purchase of issued securities from a related party	_		_	(25,000,000)
Treasury stock repurchase	_		(221,892)	_
Proceeds from issuance of securities under the ESPP	_		589,120	371,448
Proceeds from exercises of options	1,195,583		414,298	_
Payments for issuance related expenses	_		(2,625,736)	(1,604,028)
Net cash provided by financing activities	1,195,583		45,905,790	23,767,420
Net increase (decrease) in cash and cash equivalents	28,100,291		37,734,896	(12,681,810)
Cash and cash equivalents, beginning of period	159,898,608	1	22,163,712	134,845,522
Cash and cash equivalents, end of period	\$187,998,899	\$1	59,898,608	\$122,163,712
Supplemental disclosure of non-cash acti Issuance of Class A common stock in exchange for investment Issuance of Class A common stock in exchange for intangible asset Issuance of warrants in exchange for intangible asset Cancellation of subscription receivable	vities:	\$ \$ \$	6,970,907 500,000 197,000 1,250,000	
Acquisition of TreasuryConnect: Fixed assets Goodwill		\$	1,000,000 3,184,773	
Total fair value of assets			4,184,773	
Less issuance of Class A common stock			(4,013,992)	
Cash paid		\$	170,781	

See notes to the consolidated financial statements.

Consolidated Statements of \Stockholders' Equity\ >>>

For the years ended December 31, 2002, 2001 and 2000

(continued)

Unamortized

						Expense of			
		Common	Common	Additional		Business			Total
	Preferred	Stock	Stock	Paid-in	Subscription	Partner	Treasury	Accumulated	Stockholders'
	Stock	Class A	Class B	Capital	Receivable	Securities	Stock	Deficit	Equity
Balance, December 31, 1999	\$ —	\$103,500	\$406,500	\$147,588,726	\$ —	\$ —	\$ —	\$(12,586,913)	\$135,511,813
Conversions of Class B common stock to Class A common stock (5,129,520 shares)	_	51,295	(51,295)	_	_	_	_	_	_
Issuance of Preferred Stock (8,000,000 shares)	80,000	_	_	2,155,200	_	_	_	_	2,235,200
Issuance of Class A common stock (56,748 shares)	_	567	_	2,599,433	(1,250,000)	_	_	(1,350,000)	_
Purchase of Class A common stock from related party (789,071 shares)	_	_	_	_	_	_	(25,000,000)	_	(25,000,000)
Sale of Class A common stock (issuance and sale of 789,071 new shares and sale of									
789,071 shares from treasury stock)	_	7,891	_	24,992,109	_	_	25,000,000	_	50,000,000
Issuance of warrants	_	_	_	29,805,305	_	_	_	_	29,805,305
Costs of issuance of securities	_	_	_	(1,604,028)	_	_	_	_	(1,604,028)
Issuance of Class A common stock under the ESPP (16,863 shares)	_	169	_	371,279	_	_	_	_	371,448
Net loss	_	_	_	_	_	_	_	(59,061,985)	(59,061,985)
Balance, December 31, 2000	\$80,000	\$163,422	\$355,205	\$205,908,024	\$(1,250,000)	\$ —	\$ —	\$(72,998,898)	\$132,257,753
Conversions of Class B common stock to Class A common stock (7,165,743 shares)	_	71,658	(71,658)	_	_	_	_	_	_
Secondary public offering of Class A common stock (2,500,000 shares)	_	25,000	_	47,725,000	_	_	_	_	47,750,000
Issuance of Class A common stock (534,046 shares)	_	5,340	_	11,696,604	_	_	_	_	11,701,944
Issuance of warrants	_	_	_	3,786,000	_	(3,589,000)	_	_	197,000
Issuance of preferred stock (750 shares)	8	_	_	110,917	_	_	_	_	110,925
Amortization of and charges for warrants	_	_	_	214,606	_	897,100	_	_	1,111,706
Issuance of Class A common stock for Deferral Plan match (14,050 shares)	_	140	_	223,502	_	_	_	_	223,642
Issuance of Class A common stock under the ESPP (44,168 shares)	_	442	_	588,678	_	_	_	_	589,120
Issuance of Class A common stock from exercises of options (18,833 shares)	_	188	_	414,110	_	_	_	_	414,298
Cancellation of subscription receivable (28,374 shares)	_	(284)	_	(1,249,716)	1,250,000	_	_	_	_
Treasury stock repurchase (24,600 shares), at cost	_	_	_	_	_	_	(221,892)	_	(221,892)
Costs of issuance of securities	_	_	_	(2,625,736)	_	_	_	_	(2,625,736)
Net loss	_	_	_	_	_	_	_	(18,326,952)	(18,326,952)
Balance, December 31, 2001	\$80,008	\$265,906	\$283,547	\$266,791,989	\$ —	\$(2,691,900)	\$ (221,892)	\$(91,325,850)	\$173,181,808
Conversions of Class B common stock to Class A common stock (2,965,900 shares)	_	29,659	(29,659)	_	_	_	_	_	_
Amortization of and charges for warrants	_	_	_	862,694	_	1,196,400	_	_	2,059,094
Issuance of Class A common stock from exercises of options (221,277 shares net of									
retirement of 2,733 shares)	_	2,214	_	1,193,369	_	_	_	_	1,195,583
Issuance of Class A common stock for Deferral Plan match (5,814 shares)	_	58	_	52,152	_	_	_	_	52,210
Net income	_		_	_		_	_	41,966,352	41,966,352
Balance, December 31, 2002	\$80,008	\$297,837	\$253,888	\$268,900,204	s –	\$(1,495,500)	\$ (221,892)	\$(49,359,498)	\$218,455,047

See notes to the consolidated financial statements.

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\Notes\ to Consolidated Financial Statements >>>

\Note 1\

Summary of Significant Accounting Policies

- > > Basis of Presentation: eSpeed, Inc. (eSpeed or, together with its wholly-owned subsidiaries, the Company) primarily engages in the business of operating interactive vertical electronic marketplaces designed to enable market participants to trade financial and non-financial products more efficiently and at a lower cost than traditional trading environments permit. All significant intercompany balances and transactions have been eliminated in consolidation.
- > > The Company is a majority-owned subsidiary of Cantor Fitzgerald Securities (CFS), which in turn is a 99.5%-owned subsidiary of Cantor Fitzgerald, L.P. (CFLP or, together with its subsidiaries, Cantor). eSpeed commenced operations on March 10, 1999 as a division of CFS. eSpeed is a Delaware corporation that was incorporated on June 3, 1999. In December 1999, the Company completed its initial public offering.
- > > Use of Estimates: The preparation of the consolidated financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of the assets and liabilities, revenues and expenses, and the disclosure of contingent assets and liabilities in the consolidated financial statements. Management believes that the estimates utilized in preparing the consolidated financial statements are reasonable and prudent. Estimates, by their nature, are based on judgment and available information. As such, actual results could differ from the estimates included in these consolidated financial statements.
- > > Transaction Revenues: Securities transactions and the related transaction revenues are recorded on a trade date basis.

- >> Software Solutions Fees: Pursuant to various services agreements, the Company recognizes fees from related parties in amounts generally equal to its actual direct and indirect costs, including overhead, of providing such services at the time when such services are performed. For specific technology support functions that are both utilized by the Company and provided to related parties, the Company allocates the actual costs of providing such support functions based on the relative usage of such support services by each party. In addition, certain clients of the Company provide online access to their customers through use of the Company's electronic trading platform. The Company receives up-front and/or periodic fees from unrelated parties for the use of its platform. Such fees are deferred and recognized as revenue ratably over the term of the licensing agreement. The Company also receives patent license fees from unrelated parties. Such fees are recognized as income ratably over the license period.
- > > Cash and Cash Equivalents: The Company considers all highly liquid investments with original maturity dates of 90 days or less at the date of acquisition to be cash equivalents. Cash equivalents consist of securities purchased under agreements to resell (Reverse Repurchase Agreements). It is the policy of the Company to obtain possession of the collateral with a market value equal to or in excess of the principal amount deposited. Collateral is valued daily and the Company may require counterparties to deposit additional collateral or return amounts deposited when appropriate.
- > > Fixed Assets: Fixed assets, principally computer and 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 of 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.

>>> Investments: The Company accounts for its investments in entities at historical cost when the Company does not have significant influence in the investee. Investments in which the Company does have significant influence are accounted for using the equity method.

> > Intangible Assets: Intangible assets consist primarily of purchased patents. The costs incurred in filing and defending patents are capitalized when management believes such costs serve to enhance the value of the patent. Capitalized costs related to issued 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.

> > Stock-Based Compensation: Awards to employees of options to purchase the common stock of the Company are accounted for under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No expense is recognized for awards under non-compensatory plans. Options and warrants granted to non-employees are accounted for under the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation," where the options or warrants granted are recognized based on the fair value of the options or warrants at the time of the grant.

>> New Accounting Pronouncements: In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," (SFAS 146) which supersedes prior accounting guidance, Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit and Activity (including Certain Costs Incurred in a Restructuring)." SFAS 146 prescribes new guidelines for recognition of costs associated with exit or disposal activities. The provisions of SFAS 146 are effective for disposal activities initiated after December 31, 2002.

> > In January 2003, the FASB issued FASB Interpretation No. 46 (FIN 46) "Consolidation of Variable Interest Entities—an Interpretation of Accounts Research Bulletin (ARB) No. 51." FIN 46 provides guidance on the consolidation of entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 is effective immediately for entities created after January 31, 2003. The provisions of FIN 46 should be applied to entities created before February 1, 2003 no later than the beginning of the first interim or annual reporting period beginning after June 15, 2003. The Company will adopt FIN 46 as required in 2003 and is currently evaluating its impact on its consolidated financial statements.

>> On December 31, 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure" (SFAS 148). SFAS 148 permits three alternative methods of transition for a voluntary change to the fair value based method of accounting for employee based stock compensation. SFAS 148 continues to permit prospective application for companies that adopt it prior to the beginning of fiscal year 2004. SFAS 148 also allows for a modified prospective application, which requires the fair value of all unvested awards to be amortized over the remaining service period, as well as restatement of prior year's expense. The transition guidance and annual disclosure provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002, with earlier application permitted in certain circumstances. Management does not currently anticipate changing its method of accounting for stock compensation and, accordingly, SFAS 148 is not expected to have any effect on the Company's financial statements.

> > Reclassifications: Certain reclassifications have been made to prior year balances in order to conform to the current year presentation.

\Note 2September 11 Events

- > > On September 11, 2001, the Company's principal place of business at One World Trade Center was destroyed and, in connection therewith, the Company lost 180 employees and Cantor and TradeSpark lost an aggregate of 478 employees (the September 11 Events).
- > > Through the implementation of its business recovery plan, the Company immediately relocated its surviving employees to various locations in the New York metropolitan area. The United States government bond markets were closed on September 11, 2001 and September 12, 2001. By the time the United States government bond markets reopened on September 13, 2001, the Company had reestablished global connectivity of its eSpeed® system. The Company's operating proprietary software was unharmed.
- > > As a result of the September 11 Events, fixed assets with a book value of \$17,796,420 were destroyed. The Company has recovered these losses through its \$40,000,000 of property insurance coverage and, as such, has not recorded a net loss related to the destruction of its fixed assets.
- > > In addition, the Company is in the process of replacing assets that were destroyed in connection with the September 11 Events. The Company's property insurance covers full replacement cost of the assets actually replaced. To the extent that the cost of assets replaced exceeds the carrying value of the assets destroyed, the Company would record a gain on replacement of assets resulting from potential additional recoveries under the Company's property and casualty coverage. As of December 31, 2002, the Company had recovered \$20,476,420 of proceeds, which resulted in a gain on replacement of fixed assets of \$2,680,000 at December 31, 2001. However, the Company cannot currently estimate the amount or timing of any additional recoveries under its insurance coverage, and accordingly, no gains on replacement of fixed assets have been recorded during the year ended December 31, 2002.

- > > In 2001, the Company recognized a net provision of \$13,323,189 for non-property damage related to the September 11 Events. At December 31, 2001, the accrual balance for the September 11 Events was \$7,362,672 and, at December 31, 2002, no provision remains as the remaining accrual related to the September 11 Events of \$1,200,507 was reversed.
- > > The following table summarizes the September 11 provision activity for the year ended December 31, 2002:

		Accrual	Accrual
	Accrual for utilize		reversed
	September 11	during the	during the
	Events as of	period ended	period ended
	December 31, December		December 31,
	2001	2002	2002
Professional and			
consulting fees	\$ 535,023	\$ 535,023	s —
Recruitment	2,961,563	2,195,005	766,558
Restructuring	2,315,778	2,315,778	_
Other	1,550,308	1,116,359	433,949
Accrual for Septem-			
ber 11 Events	\$7,362,672	\$6,162,165	\$1,200,507

- > > During the year ended December 31, 2002, CFLP received \$40,000,000 of insurance proceeds pursuant to business interruption insurance coverage, of which \$12,832,886 was allocated to the Company. Such amount was received from CFLP and recognized as income as reflected in the accompanying consolidated statement of operations. This allocation was based on an analysis prepared by an independent consultant.
- > > CFLP intends to continue to distribute 25% of its profits, that would otherwise be distributable to its partners, for the benefit of the families of the Company's employees who were lost on September 11, 2001. From such distributions, CFLP will provide 10 years of healthcare benefits to the families. These costs will be borne by CFLP and not by the Company.

(continued)

\Note 3Fixed Assets

> > Fixed assets consist of the following:

	December 31, 2002	December 31, 2001
Computer and communication		
equipment	\$ 20,050,177	\$ 10,021,648
Software, including software		
development costs	27,659,228	18,870,472
Leasehold improvements and other fixed assets	1,128,370	474,525
	48,837,775	29,366,645
Less accumulated depreciation		
and amortization	(22,454,185)	(10,229,376)
Fixed assets, net	\$ 26,383,590	\$ 19,137,269

>> As a result of the September 11 Events, fixed assets with a net book value of \$17,796,420 were destroyed and \$2,299.913 of software development costs were written off.

\Note 4 Intangible Assets

>>> Wagner Patent: On April 3, 2001, the Company purchased the exclusive rights to United States Patent No. 4.903.201 (the Wagner Patent) dealing with the process and operation of electronic futures trading systems that include, but are not limited to, energy futures, interest rate futures, single stock futures and equity index futures. The Company purchased the Wagner Patent from Electronic Trading Systems Corporation (ETS) for an initial payment of \$1,750,000 in cash and 24,334 shares of the Company's Class A common stock valued at \$500,000. The patent expires in 2007. Additional payments are contingent upon the generation of patent-related revenues. Accordingly, the Company paid approximately \$234,000 during the year ended December 31, 2002 in connection with a long-term license agreement with InterContinentalExchange (See Note 7). In order to perfect and defend the Company's rights under the patents, the Company has incurred substantial legal costs. The Company capitalized \$13,741,691 and \$6,283,142 of such legal costs

for the years ended December 31, 2002 and 2001, respectively. The carrying value of the Wagner Patent, including capitalized patent defense costs, is presented net of accumulated amortization in the accompanying statement of financial condition and was \$18,550,050 and \$8,025,491 at December 31, 2002 and 2001, respectively.

>> On August 6, 2002, the Company entered into a Settlement Agreement (the Settlement Agreement) with ETS, the Chicago Mercantile Exchange Inc. (CME) and the Board of Trade of the City of Chicago (CBOT) to resolve the litigation related to the Wagner Patent. As part of the Settlement Agreement, all parties will be released from the legal claims brought against each other without admitting liability on the part of any party. Under the terms of the Settlement Agreement, CME and CBOT will each pay \$15 million to eSpeed as a fully paid-up license, for a total of \$30 million. Each \$15 million payment includes \$5 million, which was received in the three months ended September 30, 2002, and \$2 million per year until 2007. Of the \$30 million to be received by the Company, \$5,750,000 may be paid to ETS in its capacity as the former owner of the Wagner Patent, and \$24,250,000 is to be recognized as revenue ratably over the remaining useful life of the patent. For the year ended December 31, 2002, \$2,750,000 was paid to ETS and the Company has recorded revenue of \$1,796,074 related to the Settlement Agreement, which is included in Software Solutions and licensing fees from unrelated parties.

> > Lawrence Patent: On August 7, 2001, the Company purchased the exclusive rights to United States Patent No. 5,915,209 (the Lawrence Patent) covering electronic auctions of fixed income securities. The patent expires in 2014. The Company purchased the Lawrence Patent for \$900,000 payable over three years, and 15,000 warrants to purchase the Company's Class A common stock at an exercise price of \$16.08, which were valued at \$197,000. The warrants expire on August 6, 2011. Additional payments are contingent upon the generation of patent-related revenues. The carrying value of the Lawrence patent net of accumulated amortization was \$977,455 and \$1,097,000 at December 31, 2002 and 2001, respectively.

\Note 5Income Taxes

> > The provision for income taxes consisted of:

	Year ended December 31,					
	2002 2001 200					
		(in th	ousand	s)		
Current:						
U.S. federal	\$ _	\$	_	\$	_	
U.S. state and local	479		531		406	
Non-U.S.	_		_		_	
	479		531		406	
Deferred	_		_		_	
Provision for income taxes	\$ 479	\$	531	\$	406	

> > Differences between the Company's actual income tax expense (benefit) and the amount calculated utilizing the U.S. federal statutory rate are as follows:

	Year ended December 31,				
	2002 2001 20				
		(in thousands	:)		
Federal income tax					
(benefit) expense at					
35% statutory rate	\$ 14,857	\$(6,229)	\$(20,529)		
State taxes, net of					
federal benefit	1,816	(765)	(2,522)		
State and City capital taxes	479	531	406		
Non-deductible business					
partner securities	150	114	782		
Other non-deductible/					
(taxable) items	(113)	564	430		
Exercise of employee					
stock options	(820)	_	_		
Decrease in valuation allow-					
ance for deferred items					
currently recognized	(15,890)	_	_		
Tax benefit of net operating					
loss not currently recognized	_	6,316	21,839		
	\$ 479	\$ 531	\$ 406		

> > 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. Significant components of the Company's deferred tax assets and liabilities at December 31, 2002 and 2001 were as follows:

	Year ended		
	December 31,		
	2002	2001	
	(in tho	usands)	
Deferred tax assets:			
Non-deductible warrant expense	\$ 12,096	\$ 11,922	
Net operating loss carryforwards	6,489	19,209	
Provision for September 11 Events	_	2,945	
Basis difference of investments	1,192	359	
Non-employee stock options	1,137	1,137	
Other deferred and accrued expenses	1,317	1,613	
Total deferred tax asset	22,231	37,185	
Deferred tax liabilities:			
Software capitalization	3,396	2,725	
Gain on replacement of assets	1,072	1,072	
Depreciation of fixed assets	961	670	
Other	76	102	
Total deferred tax liability	5,505	4,569	
Net deferred tax asset	16,726	32,616	
Valuation allowance	(16,726)	(32,616)	
Net deferred income tax	s —	\$ —	

- >> At December 31, 2002, the Company had net operating loss carryforwards for income tax purposes of approximately \$16,222,000, which if not utilized, are scheduled to expire in 2021.
- > > As reflected in the above table, the Company established a valuation allowance against the net deferred tax asset of approximately \$16,726,000 and \$32,616,000 at December 31, 2002 and 2001, respectively. The valuation

allowance primarily relates to non-deductible warrant expenses and net operating loss carryforwards where there is significant uncertainty as to their ultimate realization. Additionally, the tax benefits associated with the employee exercises on incentive stock options would normally serve to reduce taxes currently payable. However, at December 31, 2002, the valuation allowance has been increased by the \$820,000 tax benefit of such, which will be recorded to additional paid-in capital if and when realized.

\Note 6Commitments and Contingencies

> > Leases: Under an administrative services agreement, the Company is obligated to Cantor for minimum rental payments under Cantor's various non-cancelable leases with third parties, principally for office space and computer equipment, expiring at various dates through 2016 as follows:

For the year ended December 31:

2003	\$ 2,580,589
2004	1,917,092
2005	1,807,113
2006	1,912,753
2007	2,100,892
Thereafter	17,635,233
Total	\$27,953,672

> > Rental expense under the above and under all other operating leases for the years ended December 31, 2002, 2001 and 2000 was \$5,929,205, \$10,988,614 and \$7,341,614, respectively.

> > Legal Matters: In the ordinary course of business, the Company and Cantor are defendants or co-defendants in various litigation matters. For certain pending litigation matters or supplemental allegations surrounding Cantor's limited partnership agreement, Cantor has agreed to indemnify the Company with respect to any liabilities the Company

may incur as a result of such lawsuits or allegations. Although there can be no assurances, the Company believes, based on information currently available and consultation with counsel, that the ultimate resolution of these legal proceedings will not have a material adverse effect on its financial condition or results of operations.

> > Risks and Uncertainties: The majority of the Company's revenues consist of transaction fees earned from Cantor based on fixed percentages of certain commissions paid to Cantor. Consequently, any reductions in the amounts of such commissions paid to Cantor could have a material adverse effect on the Company's most significant source of revenues. In addition, the Company's and Cantor's revenues could vary based on the transaction volumes of financial markets around the world.

Note 7\ Acquisitions, Investments, and Business Partner Transactions

>>> Williams and Dynegy: In June 2000, the Company sold to The Williams Companies, Inc. (Williams) and Dynegy, Inc. (Dynegy) one Unit each consisting of (i) 789,071 shares (the Shares) of the Company's Class A common stock and (ii) warrants (the Warrants) exercisable for the purchase of up to 666,666 shares of Class A common stock, for an aggregate purchase price for each Unit of \$25,000,000. The Warrants have a per share exercise price of \$35.20, a ten-year term and are exercisable during the last 41/2 years of the term, subject to acceleration under certain prescribed circumstances intended to provide incentives to Williams and Dynegy to invest in four Qualified Verticals as described below. The Shares were not transferable prior to the first anniversary of the Closing. The Company recorded a non-cash charge of \$29,805,305 at the time of the Closing to reflect the value of the Warrants.

- > > Each of Williams and Dynegy agreed that, subject to the satisfaction of certain conditions, it would invest \$2,500,000 in at least four entities (the Qualified Verticals) formed by the Company and Cantor within 12 months of the Closing. In June 2001, the initial agreed-upon period was extended by the parties to a period not to exceed two years. Investment by Williams and Dynegy was contingent upon the Company and Cantor offering seven Qualified Verticals for investment. If the Company and Cantor fail to provide seven Qualified Vertical markets for Williams and Dynegy to invest in, there will be no additional investment by Williams and Dynegy and they will continue to hold fully vested Warrants. To the extent that either Williams or Dynegy does not invest in at least four Qualified Verticals, such entity will be required to make a \$2,500,000 payment to the Company for each investment not made. TradeSpark, the first Qualified Vertical, was established in September 2000. Williams and, subject to certain limitations, Dynegy, will be entitled to invest \$25,000,000 in shares of the Company's Class A common stock (the Additional Investment Right) if they invest in the Qualified Verticals. Such right provides for investment at a 10% discount to the average trading price for the 10 trading days preceding the date of such party's investment in such new Qualified Vertical, or, under certain circumstances, the public announcement of the formation of such Qualified Vertical. The Additional Investment Right was approved by stockholders at the Company's 2000 Annual Meeting of Stockholders on October 26, 2000.
- > > The Company entered into an agreement with Cantor providing that, if and when an Additional Investment Right is exercised by Williams or Dynegy, the Company will purchase from Cantor half the number of shares purchased by Williams or Dynegy. The purchase price to be paid to Cantor by the Company will be the same purchase price per share as is paid by Williams and Dynegy at the time. Accordingly,

the purchase of any shares by the Company from Cantor will be simultaneous with the sale of an equal number of shares by the Company to Williams or Dynegy, and this part of the transaction will have no resulting effect on the Company's results of operations or total outstanding common stock.

- > > TradeSpark: On September 25, 2000, the Company and Cantor, in conjunction with Williams and other participants in the energy market, formed TradeSpark to operate a wholesale electronic and telephonic marketplace in North America for natural gas, electricity, coal, emissions allowances, and weather financial products.
- > > The Company invested \$2,000,000 for a 5% interest in TradeSpark and Cantor invested \$4,250,000 and contributed certain assets in exchange for a 28.33% interest. The remaining 66.67% interest was purchased by energy industry market participants (EIPs). The Company has also entered into a technology services agreement with TradeSpark pursuant to which the Company provides the technology infrastructure for the transactional and technology related elements of the TradeSpark marketplace as well as certain other services in exchange for specified percentages of transaction revenues from the marketplace.
- > > In order to provide incentives to the EIPs to trade on the TradeSpark electronic marketplace, the Company issued 5,500,000 shares of Series A Redeemable Convertible Preferred Stock (Series A Preferred Stock) and 2,500,000 shares of Series B Redeemable Convertible Preferred Stock (Series B Preferred Stock) to a limited liability company newly-formed by the EIPs. Upon the satisfaction of certain revenue thresholds and other conditions, principally related to the volume of transactions executed through the TradeSpark marketplace, the Series A Preferred Stock and Series B Preferred Stock are convertible into Series A and B Warrants, respectively, to collectively purchase up to

8,000,000 shares of the Company's Class A common stock at an exercise price of \$27.94 per share. To the extent that the conditions to full conversion are not satisfied, each share of unconverted Series A and B Preferred Stock may be redeemed at the Company's option, or may be converted into 1/100th of a share of the Company's Class A common stock. In 2000, the Company recognized a non-cash charge of \$2,235,200, equal to the fair value of the 80,000 shares of Class A common stock issuable upon conversion of the preferred stock, if none of the conditions are met. The Company will recognize additional non-cash charges related to the issuance of these shares of preferred stock if and when they are converted over the six-year period from date of issuance, which non-cash charges could aggregate \$53,644,800 if all conditions (including but not limited to TradeSpark total transaction revenues of at least \$250,000,000) are met and all shares of preferred stock are converted. No such additional non-cash charges were recognized during the years ended December 31, 2002 and 2001. The fair value of the Preferred Stock was estimated based on the value of the warrants into which the Preferred Stock would be converted (assuming full conversion), discounted for liquidity, hedging, and dilution issues. The warrants were valued using a modified Black-Scholes pricing model and assumptions as to riskfree interest rate, expected life and range of expected volatility of 6.3%, 10 years, and 32% to 55%, respectively.

- > > For the year ended December 31, 2002 and 2001, the Company's share of TradeSpark's losses was \$240,893 and \$211,706, respectively.
- > > In accordance with the annual assessment required by SFAS No. 142, "Goodwill and Other Intangible Assets" (SFAS 142), at December 31, 2002 the carrying value of the Company's investment in TradeSpark was written down by \$950,000 to its net realizable value.

> > Freedom: The Company and Cantor formed a limited partnership (the LP) to acquire an interest in Freedom International Brokerage (Freedom), a Canadian government securities broker-dealer and Nova Scotia unlimited liability company. On April 4, 2001, the Company contributed 310,769 shares of its Class A common stock, valued at \$6,970,907, to the LP as a limited partner, which entitles the Company to 75% of the LP's capital interest in Freedom. The Company shares in 15% of the LP's cumulative profits but not in cumulative losses. Cantor contributed 103,588 shares of the Company's Class A common stock as the general partner. Cantor will be allocated all of the LP's cumulative losses or 85% of the cumulative profits. The LP exchanged the 414,357 shares for a 66.7% interest in Freedom. In addition, the Company issued fully vested, non-forfeitable warrants to purchase 400,000 shares of its Class A common stock at an exercise price per share of \$21.31 to provide incentives over the three-year period ending April 2004 to the other Freedom owner participants to migrate to the Company's fully electronic platform. The warrants were valued using a modified Black-Scholes pricing model and assumptions as to risk-free interest rate, expected life and expected volatility of 6%, five years and 50%, respectively. The Company recorded additional paid-in capital and unamortized expense of business partner securities of \$3,589,000 in 2001, representing the value of the warrants. Non-cash charges of \$1,196,400 and \$897,100 have been recognized for the years ended December 31, 2002 and 2001, respectively. The remaining unamortized balance of \$1,495,500 will be recognized as an expense ratably through April 2004. To the extent necessary to protect the Company from any allocation of losses, Cantor is required to provide future capital contributions to the LP up to an amount that would make Cantor's total contribution equal to the Company's initial investment in the LP. The Company receives 65% of all electronic transaction services revenues and Freedom receives 35% of such revenues. The Company also receives 35% of revenues derived from Freedom's voice-assisted transactions, other miscellaneous transactions and the sale of market data or other information.

- > > The Company entered into this transaction principally to expand its business in Canadian fixed income, foreign exchange and other capital markets products and to leverage its opportunities to transact business with the six leading Canadian financial institutions that are participants in Freedom. The Company believes that Freedom may experience significant short-term losses as the voice brokerage business of Freedom is converted to a fully electronic marketplace. Accordingly, the Company was willing to accept a reduced profits interest in order to avoid recognizing potentially significant short-term losses prior to the anticipated achievement by Freedom of profitability. The Company determined the appropriate number of shares and warrants to be issued in this transaction based on the anticipated benefits to be realized and the structure of the profit and loss arrangement.
- > > The Company's share of the income of the LP for the years ended December 31, 2002 and 2001 was \$51,325 and \$63,868, respectively. The carrying value of the Company's investment in the LP at December 31, 2002 and 2001 was \$7,086,102 and \$7,034,777, respectively.
- > > TreasuryConnect: On May 25, 2001, the Company acquired all the interests in TreasuryConnect LLC, a company that operated an electronic trade communication and execution platform for OTC derivatives, in exchange for 188,009 shares of the Company's Class A common stock, valued at \$4,013,992 and cash of \$170,781. The net assets acquired consisted of \$1,000,000 of fixed assets, primarily related to software. The remaining portion of the purchase price was allocated to goodwill. As a result of the September 11 Events, the Company wrote off the goodwill of \$3,184,773

associated with the acquisition, which was included in the provision for September 11 Events in the accompanying consolidated statements of operations.

- >> > Other Unconsolidated Investments: On September 7, 2001, the Company wrote off its investments in QV Trading Systems and Visible Markets, each of which ceased operations in the third quarter of 2001. The Company recognized a loss of \$3,833,679 related to the write-offs of these unconsolidated investments.
- > > Deutsche Bank: On July 30, 2001, the Company entered into an agreement to form a business partner relationship with Deutsche Bank, AG (Deutsche Bank), whereby Deutsche Bank will channel its electronic market-making engines and liquidity for specified European fixed income products using the Company's electronic trading platform. In connection with the agreement, Deutsche Bank purchased 750 shares of Series C Redeemable Convertible Preferred Stock (Series C Preferred) of the Company at its par value of \$0.01 per share. Each share of the Series C Preferred is convertible at the option of Deutsche Bank into 10 shares of the Company's Class A common stock at any time during the five years ending July 31, 2006. The Company has recognized a non-cash charge of \$110,925, representing the fair value of such Class A common stock into which the Series C Preferred may be converted, if none of the future conditions are met. Such value in excess of the cash proceeds was given as an inducement to Deutsche Bank to enter into the agreement.
- >>> At the end of each year of the five-year agreement in which Deutsche Bank fulfills its liquidity and market-making obligations for specified products, 150 shares of Series C Preferred will automatically convert into warrants to purchase 150,000 shares of the Company's Class A common stock at an exercise price of \$14.79 per share. If all conditions are met and all of the shares of preferred stock

are converted, the total non-cash charge could aggregate \$3,330,000 over the next five years. The Company will recognize the contingent non-cash charges on a straight-line basis over the five-year period as conditions are satisfied. For the years ended December 31, 2002 and 2001, the Company has recognized non-cash charges of \$429,212 and \$214,606, respectively. Deutsche Bank is deemed to have fulfilled its obligations under the agreement for the 12 months ended July 30, 2002, and accordingly, is entitled to warrants to purchase 150,000 shares of the Company's Class A common stock.

- > > At the end of the five-year period, to the extent that Deutsche Bank does not fulfill its obligations under the agreement and Series C Preferred shares remain outstanding, the Company has the option to redeem each share of the Series C Preferred outstanding in exchange for 10 shares of the Company's Class A common stock.
- > > EasyScreen PLC: In October 2001 the Company purchased a secured convertible bond (the Bond) in the principal amount of 2,000,000 British Pounds Sterling issued by EasyScreen PLC. The Bond matures on October 29, 2006, subject to earlier conversion or repayment, accrues interest at a rate of 9% per year which accumulates and is payable to the Company pro-rata on the date of repayment or conversion. As of December 31, 2002 and 2001, the carrying value of the bond was \$3,509,000 and \$2,966,068, respectively, which is included in investments in the accompanying consolidated statement of financial condition.
- >> InterContinentalExchange: On March 29, 2002, the Company entered into an agreement with InterContinentalExchange (ICE, or the ICE Agreement) granting use of the Wagner Patent to ICE. Under the terms of the ICE Agreement, ICE pays the Company an annual royalty of \$2,000,000 per year. Such annual payment is recognized as income ratably throughout the year. The unearned

portion of the annual royalty, amounting to \$500,000 at December 31, 2002, is included in accounts payable and accrued liabilities. ICE will also pay to the Company \$0.10 for each contract that participants submit to the electronic futures exchange for trading, or \$0.20 for each contract contained in matched trades on the electronic futures exchange. The ICE Agreement will remain in effect until February 7, 2007, unless certain contingencies are not met.

- > > UBS: On August 21, 2002, the Company entered into an agreement with UBS USA, Inc. (UBS) and Cantor for UBS to execute trades electronically on the eSpeed® system in U.S. Treasury Securities, Agency Securities, European Government Bonds, UK Gilts, Japanese Government Bonds and swaps of these various securities instruments. The agreement has an initial term of two and one-half years, commencing as of January 1, 2002. In addition to quarterly participation fees paid to Cantor, UBS pays transaction fees to Cantor for each executed transaction, which are shared with the Company pursuant to the Joint Services Agreement.
- > > In addition, the Company issued to UBS a warrant to purchase 300,000 shares of its Class A common stock. The warrant has a term of 10 years and has an exercise price egual to \$8.75, the market value of the underlying Class A common stock on the date of issuance. The warrant is fully vested and nonforfeitable, and is exercisable nine years and six months after issuance, subject to acceleration upon the satisfaction by UBS of its yearly commitment condition. The Company recorded additional paid-in capital and unamortized expense of business partner securities of \$2,189,910, representing the value of the warrants. This amount will be amortized over the term of the agreement. The Company agreed to issue an additional warrant to purchase 200,000 shares of its Class A common stock at an exercise price equal to the market value of the underlying Class A common stock on the date of issuance if the agreement is renewed for another two and one-half years. For the 12 months

ended December 31, 2002, the Company has recognized a non-cash charge of \$433,487 related to the amortization of the UBS warrants.

> > TSI Holdings, Inc.: In December 2002, the Company purchased software from TSI Holdings, Inc. for \$825,000 which is included in fixed assets in the accompanying consolidated statement of financial condition. The software is being amortized using the straight-line method over the estimated useful life of three years.

\Note 8Related Party Transactions

- > > All of the Company's Reverse Repurchase Agreements are transacted on an overnight basis with CFS. Under the terms of these agreements, the securities collateralizing the Reverse Repurchase Agreements are held under a custodial arrangement with a third-party bank and are not permitted to be sold or repledged. The fair value of such collateral at December 31, 2002 and 2001 totaled \$189,588,910 and \$159,941,811, respectively.
- > > Under the Amended and Restated Joint Services Agreement between the Company and Cantor and services agreements between the Company and TradeSpark, Freedom, MPLLC and CO2e, the Company owns and operates the electronic trading system and is responsible for providing electronic brokerage services, and Cantor, TradeSpark, Freedom, MPLLC or CO2e provides voiceassisted brokerage services, fulfillment services, such as clearance and settlement, and related services, such as credit risk management services, oversight of client suitability and regulatory compliance, sales positioning of products and other services customary to marketplace intermediary operations. In general, if a transaction is fully electronic, the Company receives 65% of the aggregate transaction revenues and TradeSpark or Freedom receives 35% of the transaction revenues. If TradeSpark or Freedom provides

voice-assisted brokerage services with respect to a transaction, then the Company receives 35% of the revenues and TradeSpark or Freedom receives 65% of the revenues. The Company and MPLLC each receive 50% of the fully electronic revenues related to municipal bonds. The Company's agreement with CO2e provides that it receives 50% of CO2e's fully electronic revenues and 15% of CO2e's voice-assisted and open outcry revenues until December 2003, and 20% of voice assisted and open outcry revenues thereafter. In addition, the Company receives 25% of the net revenues from Cantor's gaming businesses.

- > > Under those services agreements, the Company has agreed to provide Cantor, TradeSpark, Freedom, MPLLC and CO2e technology support services, including systems administration, internal network support, support and procurement for desktops of end-user equipment, operations and disaster recovery services, voice and data communications, support and development of systems for clearance and settlement services, systems support for brokers, electronic applications systems and network support, and provision and/or implementation of existing electronic applications systems, including improvements and upgrades thereto, and use of the related intellectual property rights. In general, the Company charges Cantor, TradeSpark, Freedom and MPLLC the actual direct and indirect costs, including overhead, of providing such services and receives payment on a monthly basis. These services are provided to CO2e at no additional cost other than the revenue sharing arrangement set forth above. In exchange for a 25% share of the net revenues from Cantor's gaming businesses, the Company is obligated to spend and does not get reimbursed for the first \$750,000 each guarter of the costs of providing support and development services for such gaming businesses.
- > > Under an Administrative Services Agreement, Cantor provides various administrative services to the Company, including accounting, tax, legal and facilities management.

The Company is required to reimburse Cantor for the cost of providing such services. The costs represent the direct and indirect costs of providing such services and are determined based upon the time incurred by the individual performing such services. Management believes that this allocation methodology is reasonable. The Administrative Services Agreement has a three-year term which will renew automatically for successive one-year terms unless cancelled upon six months' prior notice by either the Company or Cantor. The Company incurred administrative fees for such services during the years ended December 31, 2002, 2001 and 2000 totaling \$9,134,016, \$9,797,996 and \$6,524,341, respectively.

> > The services provided under both the Amended and Restated Joint Services Agreement and the Administrative Services Agreement are not the result of arm's-length negotiations because Cantor controls the Company. As a result, the amounts charged for services under these agreements may be higher or lower than amounts that would be charged by third parties if the Company did not obtain such services from Cantor.

\Note 9Capitalization

- > > The rights of holders of shares of Class A and Class B common stock are substantially identical, except that holders of Class B common stock are entitled to 10 votes per share, while holders of Class A common stock are entitled to one vote per share. Additionally, each share of Class B common stock is convertible at any time, at the option of the holder, into one share of Class A common stock.
- > > In June 2000, the Company sold 1,578,142 shares of Class A common stock to minority investors for consideration of \$50,000,000, as discussed in Note 7. In connection with this transaction, one half of the shares sold by the Company were purchased from Cantor for \$25,000,000.

- > > In July 2000, in conjunction with the acquisition by Cantor of a municipal bond brokerage business, the Company issued 28,374 shares of Class A common stock to the shareholders of the acquired business. This stock issuance has been treated as an issuance on behalf of Cantor, and the value of the stock issued has been reflected as a direct charge to accumulated deficit in the Company's statement of financial condition. The Company also issued an additional 28,374 shares of Class A common stock to certain employees of the acquired business in exchange for promissory notes, which was recorded as a subscription receivable. The promissory notes and the related issued shares were terminated and cancelled effective December 1, 2001.
- > > In September 2000, the Company issued 8,000,000 shares of Redeemable Convertible Preferred Stock (the Preferred Stock) to business partners in conjunction with an investment in the TradeSpark Qualified Vertical. As more fully described in Note 7, if certain conditions are met, the Preferred Stock is convertible at the option of the holder into warrants to purchase the Company's Class A common stock. To the extent the conditions are not met, the Company may either redeem the Preferred Stock or convert the Preferred Stock into 1/100th of a share of the Company's Class A common stock.
- > > During the years ended December 31, 2001 and 2000, the Company sold 44,168 and 16,863 shares of Class A common stock, respectively, pursuant to the Company's Employee Stock Purchase Plan as discussed in Note 12. As a result of the Employee Stock Purchase Plan's suspension in October 2001, there was no activity in 2002.
- >> > During the years ended December 31, 2002 and 2001, the Company issued 224,010 and 18,833 shares, respectively, of Class A common stock related to the exercise of employee options which are more fully discussed in Note 11.

- > > On March 13, 2001, the Company and selling stockholders, including CFS, completed a secondary offering of 7,135,000 shares of the Company's Class A common stock to the public at \$20 per share. Of the Class A common stock offered, 2,500,000 shares were sold by the Company, and 4,635,000 shares were sold by the selling stockholders, principally CFS. Proceeds to the Company, net of underwriting discounts, but before offering expenses of \$1,940,127, totaled \$47,750,000. On April 11, 2001, CFS sold an additional 250,000 shares of Class A common stock in connection with the exercise of the underwriters' overallotment option.
- > > As more fully discussed in Note 7, in 2001 the Company issued shares of its Class A common stock in an acquisition and in business partner transactions. The Company issued 310,769 shares of its Class A common stock in the formation of a limited partnership and 188,009 shares of its Class A common stock in the acquisition of all of the interests in TreasuryConnect LLC. Additionally, the Company issued 750 shares of Redeemable Convertible Preferred Stock as part of an agreement with Deutsche Bank.
- > > On August 7, 2001, the Company issued 24,334 shares as part of its acquisition of the Wagner Patent, which is more fully discussed in Note 4.
- > > On September 10, 2001, the Company's board of directors authorized the repurchase of \$40,000,000 of outstanding Class A common stock. As of December 31, 2002 and 2001, the Company has purchased 24,600 shares for a total of \$221,892 under this repurchase plan. During the first quarter of 2003, the Company purchased an additional 161,799 shares for a total purchase price of \$1,872,112, bringing the total number of treasury shares owned to 186,399 at a book value of \$2,094,004.
- > > On August 21, 2002, the Company issued to UBS a warrant to purchase 300,000 shares of its Class A common stock as part of a business partner agreement, which is more fully discussed in Note 7.

\Note 10

Long-Term Incentive Plan

- > > The Company has adopted the eSpeed, Inc. 1999 Long-Term Incentive Plan, as amended and restated (the LT Plan), which provides for awards in the form of 1) either incentive stock options or non-qualified stock options; 2) stock appreciation rights; 3) restricted or deferred stock; 4) dividend equivalents; 5) bonus shares and awards in lieu of obligations to pay cash compensation; and 6) other awards, the value of which is based in whole or in part upon the value of the Company's Class A common stock.
- > > The Compensation Committee of the Board of Directors administers the LT Plan and is generally empowered to determine award recipients, and the terms and conditions of those awards. Awards may be granted to directors, officers, employees, consultants and service providers of the Company and its affiliates.
- >> > There were no shares issued under the LT Plan during 2002. During 2001, the Company issued 10,934 shares of restricted Class A common stock valued at \$220,247 to certain employees under the LT Plan. The Company recognized the entire value of \$220,247 of compensation expense in 2001 as the Company elected to fully vest the shares after the September 11 Events.

\Note 11\

Options and Warrants

>> Issued in Connection with the Long-Term Incentive Plan: During the years ended December 31, 2002, 2001 and 2000, respectively, the Company issued 2,471,050, 3,653,816 and 3,770,312 options to employees pursuant to the LT Plan. The exercise prices for the options equaled the value of the Company's Class A common stock on the date of each award. The options generally vest ratably over four or five years from the grant date.

- >>> On October 19, 2000, the option terms were amended so that future vesting occurs ratably on a quarterly basis. This amendment had no financial impact as the market value of the Company's Class A common stock was below the exercise price of all outstanding options at that date.
- > > As a result of the September 11 Events, the Company fully vested all options for deceased employees of the Company, Cantor and TradeSpark. In addition, the expiration date of options was extended to the fifth anniversary of the option grant date. The extension of the expiration date did not result in additional compensation expense for the year ended December 31, 2001 as the original grant price of the options was higher than the Company's stock price on the date of modification.
- > > Pursuant to guidelines contained in APB 25, the Company records no expense for options issued to employees. The weighted average grant date fair values of employee stock options granted were \$6.31, \$3.25 and \$12.42 for the years ended December 31, 2002, 2001 and 2000, respectively. The following table represents the effect had the Company accounted for the options in its stock-based compensation plan based on the fair value of awards at grant date in a manner consistent with the methodology of SFAS 123 and giving effect to the accelerated vesting of certain options as a result of the September 11 Events:

	Decrease in net	Decrease in net
	income/increase	income/increase in
Year	in net loss	net loss per share
2002	\$17,061,751	\$0.31
2001	\$37,021,370	\$0.68

>>> The fair value of the above options and warrants was estimated using a modified Black-Scholes option-pricing model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In

addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of the stock options or warrants. The following table presents the assumptions that were used in the Black-Scholes model for the years ended December 31, 2002, 2001 and 2000:

	Risk-free	Expected	Expected	
Year	interest rate	life (years)	volatility	Dividends
2002	2.43%	3.07	69.00%	None
2001	3.26%	3.08	80.00%	None
2000	5.87%	2.84	80.00%	None

> > Issued in Connection with Acquisitions, Investments and Business Partner Securities: In June 2000, the Company issued 1,333,332 warrants to purchase Class A common stock to business partners as discussed in Note 7. The warrants expire in June 2010 and are generally exercisable beginning December 2005. The estimated fair value of the warrants at the time of issuance resulted in a one-time non-cash charge to the Company of \$29,805,305. The fair value of the warrants was estimated using a modified Black-Scholes pricing model and assumptions as to risk-free interest rate, expected life and expected volatility of 7.4%, 10 years and 48%, respectively.

- > > As discussed in Note 4, on August 7, 2001, the Company issued 15,000 warrants to purchase the Company's Class A common stock as part of its purchase of a patent. The warrants expire on August 6, 2011 and the estimated fair value of the warrants issued was \$197,000.
- > > As discussed in Note 7, the Company issued 400,000 warrants to purchase the Company's Class A common stock as part of the formation of the limited partnership to acquire Freedom.

> > As discussed in Note 7, on July 30, 2002, 150 shares of Series C Redeemable Convertible Preferred Stock held by Deutsche Bank automatically converted into a right to 150,000 warrants to purchase the Company's Class A common stock as a result of Deutsche Bank being deemed to

have fulfilled its obligations under the agreement between it and the Company for the year ended July 30, 2002.

>> As discussed in Note 7, on August 21, 2002, the Company issued to UBS warrants to purchase 300,000 shares of the Company's Class A common stock.

> > Options and Warrants: The following table summarizes changes in all of the Company's stock options and warrants for the years ended December 31 2002, 2001 and 2000:

	eSpeed and Cantor employee options	Warrants and other options	Total	Weighted average exercise price	Expiration dates
Balance, December 31, 1999	6,492,865	135,000	6,627,865	\$22.00	12/2004–12/2009
Granted	3,770,312	1,333,332	5,103,644	\$25.76	2/2010-12/2010
Exercised	_	_	_	_	
Canceled	(292,460)	_	(292,460)	\$24.38	
Balance, December 31, 2000	9,970,717	1,468,332	11,439,049	\$23.62	12/2004-12/2010
Granted	3,653,816	415,000	4,068,816	\$ 6.45	1/2010-10/2011
Exercised	(18,833)	_	(18,833)	\$22.00	
Canceled	(378,371)	_	(378,371)	\$18.25	
Balance, December 31, 2001	13,227,329	1,883,332	15,110,661	\$19.76	12/2004-10/2011
Granted	2,471,050	450,000	2,921,050	\$13.13	1/2012-12/2012
Exercised	(224,010)	_	(224,010)	\$ 5.19	
Canceled	(78,771)	_	(78,771)	\$ 8.81	
Balance, December 31, 2002	15,395,598	2,333,332	17,728,930	\$18.90	12/2004–12/2012

> > The following table provides further details relating to all of the Company's stock options and warrants outstanding as of December 31, 2002.

Range of exercise prices	Number outstanding	Weighted average exercise price	Weighted average remaining contractual life (in years)	Number exercisable	Weighted average exercise price
\$ 5.10 to \$11.03	3,841,946	\$ 5.81	8.8	725,973	\$ 5.43
\$12.28 to \$18.26	4,314,149	\$15.25	7.8	1,605,827	\$15.94
\$18.99 to \$28.44	7,449,614	\$22.15	4.6	6,058,227	\$22.16
\$28.88 to \$43.06	1,746,842	\$33.37	6.6	351,598	\$35.52
\$43.38 to \$77.00	376,379	\$45.30	7.0	197,480	\$46.32
	17,728,930	\$18.90	6.5	8,939,105	\$20.30

(continued)

\Note 12Stock Purchase Plan

> > The Company has adopted a qualified Employee Stock Purchase Plan to permit eligible employees to purchase shares of eSpeed common stock at a discount. At the end of each quarterly purchase period, as defined, accumulated payroll deductions are used to purchase stock at a price determined by a Stock Purchase Plan Administrative Committee, which will generally not be less than 85% of the lowest market price at various defined dates during the purchase period. The Company has reserved 425,000 shares of Class A common stock for issuance under the Stock Purchase Plan. During the year ended December 31, 2001, the Company issued 44,168 shares to employees at an average price of \$13.33 per share. During the year ended December 31, 2000, the Company issued 16,863 shares to employees at an average price of \$21.99 per share. In October 2001, the Company suspended the ESPP. Accordingly, no shares were purchased under this plan in 2002.

\Note 13Deferred Compensation Plan

- > > Employees of the Company are eligible to participate in the eSpeed Inc. Deferral Plan for Employees of Cantor Fitzgerald, L.P. and its Affiliates (the Plan), whereby eligible employees may elect to defer a portion of their salaries by directing the Company to contribute to the Plan.
- > > The Plan is available to all employees of the Company meeting certain eligibility requirements and is subject to the provisions of the Employee Retirement Income Security Act of 1974. Employee contributions are directed to one or more investment funds, one of which, beginning in 2000, invests in the Company's Class A common stock (the eSpeed Stock Fund). The Company will match contributions to the eSpeed Stock Fund annually with up to \$3,000 of the Company's Class A common stock per participant. In 2003, 2002 and 2001, the Company contributed 7,439, 5,814 and 14,050

shares of its Class A common stock relating to employee contributions to the eSpeed Stock Fund for the year ended December 31, 2002, 2001 and 2000, respectively. The administration of the Plan is performed by CFLP. The Company pays its proportionate share of such administrative costs under the Administrative Services Agreement.

\Note 14 Regulatory Capital Requirements

- > > Through its subsidiary, eSpeed Government Securities, Inc., the Company is subject to Securities and Exchange Commission (SEC) broker-dealer regulation under Section 15C of the Securities Exchange Act of 1934, which requires the maintenance of minimum liquid capital, as defined. At December 31, 2002, eSpeed Government Securities, Inc.'s liquid capital of \$109,148,671 was in excess of minimum requirements by \$109,123,671.
- > > Additionally, the Company's subsidiary, eSpeed Securities, Inc., is subject to SEC broker-dealer regulation under Rule 17a-5 of the Securities Exchange Act of 1934 which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. At December 31, 2002, eSpeed Securities, Inc. had net capital of \$6,998,089, which was \$6,679,567 in excess of its required net capital, and eSpeed Securities, Inc.'s net capital ratio was 0.68 to 1.

\Note 15 Segment and Geographic Data Tables

> > Segment Information: The Company currently operates its business in one segment, that of operating interactive electronic business-to-business vertical marketplaces for the trading of financial and non-financial products, licensing software, and providing technology support services to Cantor and other related and unrelated parties.

> > Product Information: The Company currently markets its services through the following products: core products, including an integrated network engaged in electronic trading in government securities in multiple market-places over the eSpeed® system; new product rollouts, including introduction of products in non-equity capital markets; products enhancement software, which enables clients to engage in enhanced electronic trading of core products

and future product rollouts and eSpeed Software SolutionsSM, which allows customers to use the Company's intellectual property and trading expertise to build electronic market-places and exchanges, develop customized trading interfaces and enable real-time auctions and debt issuance. Revenues from core products comprises the majority of the Company's revenues.

> > Geographic Information: The Company operates in the Americas, Europe and Asia. Revenue attribution for purposes of preparing geographic data is principally based upon the marketplace where the financial product is traded, which, as a result of regulatory jurisdiction constraints in most circumstances, is also representative of the location of the client generating the transaction resulting in commissionable revenue. The information that follows, in management's judgment, provides a reasonable representation of the activities of each region as of and for the periods indicated.

	For the year ended December 31, 2002	For the year ended December 31, 2001	For the year ended December 31, 2000
Transaction revenues:			
Europe	\$ 24,317,324	\$20,657,534	\$13,214,668
Asia	2,580,390	2,653,378	1,397,154
Total Non-Americas	26,897,714	23,310,912	14,611,822
Americas	78,883,781	75,057,114	55,675,557
Total	\$105,781,495	\$98,368,026	\$70,287,379
	December 31, 2002	December 31, 2001	
Average long-lived assets:			
Europe	\$ 5,576,717	\$ 3,737,700	
Asia	387,632	434,809	
Total Non-Americas	5,964,349	4,172,509	
Americas	17,536,681	19,031,755	
Total	\$ 23,501,030	\$23,204,264	

Independent \Auditors' Report\ >>>

To the Board of Directors and Stockholders of eSpeed, Inc.:

- > > We have audited the accompanying consolidated statements of financial condition of eSpeed, Inc. and subsidiaries (the "Company") as of December 31, 2002 and 2001, and the related statements of operations, cash flows and stockholders' equity for the three years in the period ended December 31, 2002. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.
- > > > We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

> > In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2002 and 2001, and the results of their operations and their cash flows for the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

Debotte & Touche up

March 26, 2003 New York, New York

\Market\ for the Registrant's Common Equity and Related Stockholder Matters >>>

Price Range of Class A Common Stock

> > Our Class A common stock is traded on the Nasdaq National Market® under the symbol "ESPD." For each quarter of the prior two years and through March 17, 2003, the high and low sales prices for our Class A common stock, as reported by Nasdaq®, were as follows:

	High	Low
2001		
First Quarter	\$34.75	\$13.62
Second Quarter	\$28.23	\$16.25
Third Quarter	\$19.94	\$ 7.44
Fourth Quarter	\$ 9.00	\$ 4.60
2002		
First Quarter	\$12.21	\$ 7.91
Second Quarter	\$14.10	\$ 8.27
Third Quarter	\$11.07	\$ 7.42
Fourth Quarter	\$19.90	\$ 9.63
2003		
First Quarter (through March 17, 2003)	\$19.20	\$ 9.15

> > On March 17, 2003, the last reported closing price of our Class A common stock on the Nasdaq National Market was \$11.25 and there were 682 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 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

Use of Proceeds of Initial Public Offering

>>> The effective date of our registration statement (Registration No. 333-87475) filed on Form S-1 relating to our initial public offering of Class A common stock was December 9, 1999. In our initial public offering, we sold 7,000,000 shares of Class A common stock at a price of \$22.00 per share and Cantor Fitzgerald Securities, the selling stockholder, sold 3,350,000 shares of Class A common stock at a price of \$22.00 per share. Our initial public offering was managed on behalf of the underwriters by Warburg Dillon Read LLC, Hambrecht & Quist, Thomas Weisel Partners LLC and Cantor Fitzgerald & Co. The offering commenced on December 10, 1999 and closed on December 15, 1999. Proceeds to us from our initial public offering, after deduction of the underwriting discounts and commissions of approximately \$10.0 million and offering costs of \$4.4 million, totaled approximately \$139.6 million. Of the \$139.6 million raised, approximately \$8.9 million has been used to fund investments in various entities, approximately \$62.4 million has been used to acquire fixed assets and to pay for the development of capitalized software, approximately \$22.7 million has been used to purchase intangible assets and pay for the defense of patents, and approximately \$8.2 million has been used for other working capital purposes. The remaining \$37.4 million has been invested in reverse repurchase agreements which are fully collateralized by U.S. Government Securities held in a custodial account at a thirdparty bank.

> > Of the amount of proceeds spent through December 31, 2002, approximately \$27.1 million has been paid to Cantor under the Administrative Services Agreement between Cantor and us.

Stock Repurchase

> > In February 2003, in accordance with the stock repurchase plan authorized by our board of directors on September 10, 2001 and reaffirmed in October 2001, we repurchased an aggregate of 161,799 shares of our Class A common stock for an aggregate purchase price of \$1,872,112. The reacquired shares have been designated treasury shares and will be used for general corporate purposes.

Howard W. Lutnick

Chairman of the Board of Directors, Chief Executive Officer and President eSpeed, Inc.

Lee M. Amaitis

Global Chief Operating Officer eSpeed, Inc.

Stephen M. Merkel

Executive Vice President, General Counsel and Secretary eSpeed, Inc.

Joseph C. Noviello

Executive Vice President and Chief Information Officer eSpeed, Inc.

Larry R. Carter

Senior Vice President, Finance and Administration, Chief Financial Officer and Secretary Cisco Systems

John H. Dalton

Former Secretary of the U.S. Navy President IPG Photonics Corp.

William J. Moran

Executive Vice President and General Auditor JPMorgan Chase

Hank Morris

President
Morris & Carrick, Inc.

Albert M. Weis

Former Chairman
New York Board of Trade
President
A.M. Weis & Co., Inc.

Executive Management

Howard W. Lutnick

Chairman of the Board of Directors, Chief Executive Officer and President

Lee M. Amaitis

Global Chief Operating Officer

Jeffrey M. Chertoff

Senior Vice President and Chief Financial Officer

Stephen M. Merkel

Executive Vice President, General Counsel and Secretary

Joseph C. Noviello

Executive Vice President and Chief Information Officer

Corporate Headquarters

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International Headquarters

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Investor Relations and Requests for Annual Report on Form 10-K

Contact:

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Copies of the Company's Annual Report on Form 10-K along with news releases, other recent SEC filings and general stock information are available without charge at www.espeed.com, by calling Investor Relations at +1 212 610 2426 or by writing Investor Relations at the Company's address above.

Independent Auditors

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