CBOE: Creating new options
Option: CBOE

Options on:
1,450 equities
44 indexes
55 exchange-traded funds
4 interest rates

Home of options on the S&P®, Dow Jones®, Russell, Nasdaq® indexes, and DIAMONDS®

Option: Hybrid 1.0
Hybrid 2.0

e-DPMs, DPMs and on-floor market makers “streaming” quotes

Deeper, transparent markets, “quotes with size” and increased liquidity

Option: CBOE Futures Exchange

Electronic trading via CBOEdirect®

Futures on CBOE Volatility Index® (VIX®), Variance and CBOE China Index
By offering investors a diverse mix of innovative options, CBOE was the leading U.S. options exchange in overall volume in FY 2004.
**Index Options Volume**
In Millions, By Fiscal Year

**S&P 500 (SPX) Options Volume**
In Millions, By Fiscal Year

**Russell 2000 (RUT) Options Volume**
In Thousands, By Fiscal Year

**NASDAQ-100 Index Tracking Stock (QQQ) Options Volume**
In Millions, By Fiscal Year

**DIAMONDS Trust, Series 1 (DIA) Options Volume**
In Millions, By Fiscal Year

**Equity Options Volume**
In Millions, By Fiscal Year
Letter from the Office of the Chairman

The Chicago Board Options Exchange® (CBOE®) maintained its industry leadership position in Fiscal Year 2004 due to the implementation of major strategic initiatives to service customers and stimulate order flow in the face of intense competition in the options markets. Moreover, CBOE ended the fiscal year in a sound financial position, with increased working capital.

CBOE remained the leading U.S. options exchange in overall volume in FY 2004. A record-breaking total of 330 million contracts traded with an average daily volume in excess of 1.3 million contracts per day. This represents an increase of 22% in total volume over FY 2003, when 270 million contracts traded, and is the largest number of contracts traded in a fiscal year since FY 2001 when 319 million contracts traded.

CBOE completed the fiscal year with a pre-tax profit of $3 million, even as member fees were reduced in excess of $9 million. CBOE had approximately $37 million in working capital at the end of the fiscal year, up from $30 million at the beginning of FY 2004. It is also notable that CBOE seat prices rose 79% during FY 2004.

CBOE’s market share began to stabilize at the close of FY 2004, indicating that CBOE’s new market model, implemented during FY 2004, is having a positive effect on business. Through rolling out a revolutionary trading system and launching innovative products, including those offered through a new CBOE-owned futures exchange, CBOE created a wide range of valuable products and services for investors. CBOE is dedicated to developing new and unique trading solutions that illustrate CBOE’s commitment to remaining the marketplace of choice for as many customers as possible.
The Hybrid Trading System
Merging the Advantages of Electronic and Open Outcry Trading

On June 12, 2003, CBOE launched its new Hybrid Trading System. The technology encompassed in CBOE’s Hybrid Trading System combined the best features of screen-based and floor-based trading into a “best of both worlds” marketplace. The system enables market makers to “stream” live quotes, to post “quotes with size” and expedite order execution, allowing CBOE market makers to better showcase the quality of markets found at CBOE. The backing of Hybrid technology by CBOE’s large pool of market makers permits CBOE to offer customers greater transparency, liquidity and opportunities for price improvement.

The roll-out of hybrid trading in individual stock classes was conducted in phases to ensure a smooth conversion process. As the fiscal year ended on June 30, 2004, over 800 equity classes were being traded on Hybrid, representing over 90% of the nationally-traded equity contracts. As of the end of September 2004, 1,000 stock options classes were listed for trading on Hybrid, and additional classes continue to be added. By the end of 2004, all equity classes traded at CBOE will have been converted to trading on the Hybrid System.

To date, the initial results of Hybrid have been encouraging as disseminated bid/ask spreads for classes on Hybrid have tightened and CBOE has more consistently established the National Best Bid or Offer. In addition, through the Hybrid’s point-and-click technology, customers now have speedier access to CBOE’s deep, liquid markets.
Hybrid 2.0
The Evolution of a Revolution in Trading Systems

Significant effort was expended in Fiscal Year 2004 preparing for the next generation of the CBOE Hybrid Trading System initiative—Hybrid 2.0, which was launched on July 21, 2004. Hybrid 2.0 creates new classes of membership and enables a wider range of market participants to access the Hybrid System. Specifically, nationally-based specialists now have the opportunity to quote and trade electronically from remote locations.

A new class of members, electronic-Designated Primary Market Makers (e-DPMs), serve as electronic specialists who are able to “stream” quotes electronically from any location, offering a new option for participating in trading at CBOE. On May 4, 2004, the Exchange announced the firms it selected as CBOE e-DPMs.

In the next phase of Hybrid 2.0, CBOE is seeking regulatory approval from the Securities and Exchange Commission (SEC) to also enable our members and member firms to become Remote Market Makers (RMMs), a designation proposed for those individuals and organizations who would prefer to operate as solely off-floor market makers. In its filing to the SEC, CBOE proposes consolidating e-DPM and RMM quotes with those of CBOE’s on-floor market participants, including broker/dealers, market makers and member firms, to create a more robust marketplace with deep liquidity. The Hybrid format will continue to accommodate orders directed for open outcry execution, thus providing CBOE’s floor members and customers with opportunities for price improvement on the traditional platform. CBOE is seeking to obtain regulatory approval of the RMM program by the end of this calendar year.

The implementation of Hybrid 2.0 adds an important new dimension to our Hybrid model and is intended to strengthen CBOE’s competitive position. Our goal in developing the Hybrid System has always been to have an easily-accessible system in place that is flexible by design and efficient for trading. And because CBOE built the system entirely in-house and is the sole proprietor of the technology, we can make timely and cost-effective adaptations to the demands of the marketplace as they evolve.
CBOE Futures Exchange
Unprecedented New Opportunities to Trade Volatility

CBOE began a new chapter in product innovation in FY 2004 with the launch of the CBOE Futures Exchange, LLC (CFE). CFE is a wholly-owned subsidiary of CBOE that operates as an all-electronic exchange, using CBOEdirect® as its trading platform, with trades cleared through the Triple A-rated Options Clearing Corporation.

CFE debuted on March 26, 2004 by offering futures on the CBOE Volatility Index® (VIX®). VIX, which was created and first introduced by CBOE in 1993, is known throughout the world as the benchmark index of market sentiment and is commonly referred to as “the fear gauge” by investors and media analysts. Derived from real-time S&P 500® Index option prices, VIX is designed to reflect investors’ consensus view of expected stock market volatility over the next 30 days. The ability to trade futures on VIX for the first time ever provided a whole new option for investors and a landmark opportunity to hedge and trade volatility.

On May 18, 2004, CFE launched trading in CBOE S&P 500 Three-Month Variance Futures (VT). VT is an exchange-traded futures contract based on the realized variance of the Standard & Poor’s 500 Stock Index over a three-month period. VT is the first in what is anticipated to be an innovative series of variance products planned for CFE. Variance and volatility products provide a practical, direct means to trade the volatility of the broad market and to hedge the volatility risk of broad-based portfolios.

On October 18, 2004, CFE listed its third product and began trading futures on the newly-created CBOE China Index (CX). CBOE China Index futures are exchange-traded contracts based on the equal-dollar weighted index composed of sixteen American Depository Receipts, New York Registered Shares or NYSE Global Shares, which are traded on the New York Stock Exchange, Nasdaq or the American Stock Exchange.

We are encouraged by the initial success of CFE. Volume, liquidity, open interest and the number of market participants have grown steadily each month. We are optimistic that this trend will continue as investors become increasingly familiar with the products, and additional volatility and variance products are developed and listed on CFE.

CBOE is also a founding partner, along with Chicago Mercantile Exchange® and the Chicago Board of Trade®, of OneChicago, LLC, a joint venture exchange, which has a total of 134 products: 119 single stock futures, including futures on the DIAMONDS® Trust, and 15 futures on the Dow Jones MicroSector Indexes℠.
In today’s business environment of heightened scrutiny of corporate governance and self-regulation practices, CBOE has stood at the forefront of establishing and enforcing safeguards to ensure that its governance structure and reputation remain beyond reproach.

Well before much-publicized governance and regulatory issues surfaced in the financial and corporate arenas, CBOE instituted policies and reforms to ensure that its governance structure met the highest standards of ethical conduct and integrity. Significant steps were taken to institutionalize checks and balances, and to eliminate the potential for conflicts of interest. The Securities and Exchange Commission views these changes as very positive steps.

As early as 2002, CBOE established representative parity on its Board of Directors. The composition of the CBOE Board of Directors is now equally balanced between 11 public (independent) directors and 11 industry directors, plus the chairman of the Exchange. Last year, CBOE appointed a public director to serve in the newly-created position of Lead Director. The Lead Director plays a vital role by identifying issues raised by other directors for further Board discussion at meetings where Exchange management is not present, and also acts as a liaison between the Board and Exchange management.

CBOE has also created a Regulatory Oversight Committee composed solely of public directors, and a Governance Committee that is chaired by a public director. Public representation on the Business Conduct Committee was increased from one to three members, and an additional internal audit position was created to perform regular audits of CBOE’s regulatory activities. Public directors also chair CBOE’s Audit Committee and Compensation Committee, and these committees maintain a balance of at least 50 percent public directors.

The SEC continues to request more information about how exchanges operate, and, in that regard, CBOE will make and issue an annual financial disclosure document, in accordance with SEC requirements. The disclosure will be issued by the end of the year, and will include CBOE compensation data for the top executives at CBOE.

These actions evidence CBOE’s resolve to ensure ethical, fair and transparent governance. They also allow us to more fully utilize the expertise of both public and industry directors to chart CBOE’s course within a highly competitive marketplace.
CBOE and Public Policy
Continuing to Advocate for Fairness in the Options Industry

CBOE continues to monitor congressional hearings on the need to reform the “national market system” for the U.S. securities market. During FY 2004, hearings have focused on a broad range of issues including governance and regulatory roles, reforms to promote competition, the role of the specialist system, changes in trade-through rules, and a variety of other market structure issues, all of which will have implications for the options industry and CBOE members.

On February 3, 2004, the SEC issued a concept release, titled “Competitive Developments in the Options Markets.” The release sought comments on business practices that have emerged since the expansion of multiple listing, including payment for order flow, internalization, specialist guarantees, penny increments, the “self-regulatory organization” status of exchanges and regulatory arbitrage. CBOE submitted responses on all of these issues.

On April 21, 2004, the SEC held hearings in New York to discuss the proposed Regulation NMS (“National Market System”) and its four areas of focus: trade-through, market access, market data and sub-pennies. Forty-five industry executives appeared before the SEC panel to discuss the potential impact of Regulation NMS on the U.S. financial markets’ structure. Among the participants were CBOE Chairman William Brodsky and CBOE Vice Chairman Ed Tilly, who were asked to jointly testify on the strengths of CBOE’s Hybrid Trading System. The SEC cited CBOE’s Hybrid as an exemplary trading model that effectively incorporates floor and screen-based trading.

We expect that FY 2005 will be a very active year on the regulatory and legislative fronts, and CBOE will continue to aggressively advocate for a fair, open and efficient options marketplace for all participants.
**Moving Ahead**

**Continuing a Proud Tradition of Meeting Customers’ Needs Through Product and Technological Innovation**

The past few years have been characterized by fierce competitive assaults on CBOE. Our membership and staff responded to these challenges by virtually reinventing the way options are traded at CBOE, creating the Hybrid Trading System, one of the most innovative trading platforms in the industry. We are beginning to see the positive results of key strategic initiatives, and have laid the groundwork for a future that holds great promise.

We are optimistic that, with the continued dedication and commitment of the membership and staff, CBOE will meet all future challenges with the same indomitable spirit that has distinguished the Exchange since its founding in 1973.

Sincerely,

William J. Brodsky  
Chairman and CEO

Edward T. Tilly  
Vice Chairman

Edward J. Joyce  
President and COO
Fiscal Year 2004 (FY04) Financial Summary

Although CBOE experienced record trading volume in FY04, competitive pressures on fees and higher operating expense levels limited net income to $1.7 million versus $7.4 million in the prior year.

Total options daily volume averaged 1,308,000 contracts, an increase of 22% from the prior year’s average of 1,071,000 contracts per day. The previous record for options average daily volume was 1,271,000 contracts set in fiscal year 2001.

The significant growth in trading volume was the main reason current year revenues were $9.9 million higher than the prior year. Fee reductions and fee caps for our customers and members amounted to $9.2 million versus $5.2 million in the prior year.

Expenses were $20.7 million higher than the prior year, mainly due to employee costs ($5.2 million), royalty fees ($4.8 million), outside services ($3.4 million), travel and promotional expenses ($1.6 million) and non-cash impairment expense ($2.5 million). Employee costs were higher mainly due to increased expenses in the Systems area to meet information technology needs and year-end compensation awards. Royalty fees were higher due to new license agreements and increased expenses related to higher volume. Outside services were higher than the prior year mainly due to increased legal services. Promotional expenses were higher mainly due to increased index options marketing efforts. Impairment expense related to recognition of lower book values for our investment in the National Stock Exchange and goodwill related to the NYSE options program, purchased approximately seven years ago.

Capital spending in FY04 amounted to approximately $23.3 million. Investments were primarily in the Systems Division related to the Hybrid Trading System and other trading floor enhancements. In addition, the Exchange contributed $5.1 million in capital to OneChicago, LLC in FY04.

Retained earnings increased to $112.7 million and total members’ equity at June 30, 2004 was $133.6 million. At year’s end, the Exchange was debt-free with working capital of $36.8 million.
# CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS

Chicago Board Options Exchange, Incorporated and Subsidiaries  
For the Years Ended June 30, 2004 and 2003 (in thousands)  

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenues:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transaction fees</td>
<td>$116,344</td>
<td>$104,827</td>
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<tr>
<td>Other member fees</td>
<td>25,465</td>
<td>26,642</td>
</tr>
<tr>
<td>Options Price Reporting Authority income</td>
<td>14,543</td>
<td>15,614</td>
</tr>
<tr>
<td>Regulatory fees</td>
<td>11,289</td>
<td>10,800</td>
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<tr>
<td>Other</td>
<td>6,073</td>
<td>5,909</td>
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<tr>
<td><strong>Total Revenues</strong></td>
<td>173,714</td>
<td>163,792</td>
</tr>
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<td><strong>Expenses:</strong></td>
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<td></td>
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<tr>
<td>Employee costs</td>
<td>69,304</td>
<td>64,094</td>
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<tr>
<td>Depreciation and amortization</td>
<td>29,685</td>
<td>29,252</td>
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<tr>
<td>Data processing</td>
<td>18,022</td>
<td>17,771</td>
</tr>
<tr>
<td>Outside services</td>
<td>15,242</td>
<td>11,794</td>
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<tr>
<td>Royalty fees</td>
<td>15,847</td>
<td>11,028</td>
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<tr>
<td>Travel and promotional expenses</td>
<td>6,406</td>
<td>4,853</td>
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<tr>
<td>Facilities costs</td>
<td>4,389</td>
<td>4,240</td>
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<tr>
<td>Equity in loss of OneChicago</td>
<td>4,359</td>
<td>4,165</td>
</tr>
<tr>
<td>Impairment of investment in affiliates</td>
<td>1,763</td>
<td>0</td>
</tr>
<tr>
<td>Impairment of goodwill</td>
<td>690</td>
<td>0</td>
</tr>
<tr>
<td>Other</td>
<td>5,352</td>
<td>3,204</td>
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<tr>
<td><strong>Total Expenses</strong></td>
<td>171,059</td>
<td>150,401</td>
</tr>
<tr>
<td><strong>Income Before Income Taxes</strong></td>
<td>2,655</td>
<td>15,391</td>
</tr>
<tr>
<td><strong>Provision (Benefit) for Income Taxes:</strong></td>
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<td></td>
</tr>
<tr>
<td>Current</td>
<td>1,333</td>
<td>5,201</td>
</tr>
<tr>
<td>Deferred</td>
<td>(329)</td>
<td>798</td>
</tr>
<tr>
<td><strong>Total Provision for Income Taxes</strong></td>
<td>1,004</td>
<td>5,999</td>
</tr>
<tr>
<td><strong>Net Income</strong></td>
<td>1,651</td>
<td>7,392</td>
</tr>
<tr>
<td><strong>Retained Earnings at Beginning of Year</strong></td>
<td>111,062</td>
<td>103,670</td>
</tr>
<tr>
<td><strong>Retained Earnings at End of Year</strong></td>
<td>$112,713</td>
<td>$111,062</td>
</tr>
</tbody>
</table>

# CONSOLIDATED BALANCE SHEETS

Chicago Board Options Exchange, Incorporated and Subsidiaries  
June 30, 2004 and 2003 (in thousands)  

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Current Assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$30,254</td>
<td>$20,558</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>17,937</td>
<td>18,473</td>
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<tr>
<td>Income taxes receivable</td>
<td>1,266</td>
<td>1,519</td>
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<tr>
<td>Prepaid medical benefits</td>
<td>1,780</td>
<td>1,777</td>
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<tr>
<td>Other prepaid expenses</td>
<td>3,015</td>
<td>4,464</td>
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<tr>
<td>Other current assets</td>
<td>724</td>
<td>912</td>
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<tr>
<td><strong>Total Current Assets</strong></td>
<td>54,976</td>
<td>47,703</td>
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<tr>
<td><strong>Investments in Affiliates</strong></td>
<td>15,194</td>
<td>14,976</td>
</tr>
<tr>
<td><strong>Land</strong></td>
<td>4,914</td>
<td>4,914</td>
</tr>
<tr>
<td><strong>Property and Equipment:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Building</td>
<td>57,609</td>
<td>57,609</td>
</tr>
<tr>
<td>Furniture and equipment</td>
<td>123,144</td>
<td>110,006</td>
</tr>
<tr>
<td>Less accumulated depreciation and amortization</td>
<td>(122,186)</td>
<td>(104,577)</td>
</tr>
<tr>
<td><strong>Total Property and Equipment—Net</strong></td>
<td>58,567</td>
<td>63,038</td>
</tr>
<tr>
<td><strong>Other Assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td>698</td>
<td>1,388</td>
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<tr>
<td>Data processing software work in progress</td>
<td>5,588</td>
<td>5,440</td>
</tr>
<tr>
<td>Data processing software and other assets (less accumulated amortization—2004, $43,938; 2003, $31,854)</td>
<td>36,297</td>
<td>38,325</td>
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<tr>
<td><strong>Total Other Assets—Net</strong></td>
<td>42,583</td>
<td>45,153</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$176,234</td>
<td>$175,784</td>
</tr>
</tbody>
</table>

See notes to consolidated financial statements.
### CONSOLIDATED BALANCE SHEETS (CONTINUED)

#### Liabilities and Members’ Equity

<table>
<thead>
<tr>
<th>Current Liabilities:</th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable and accrued expenses</td>
<td>$16,610</td>
<td>$15,173</td>
</tr>
<tr>
<td>Marketing fee payable</td>
<td>66</td>
<td>687</td>
</tr>
<tr>
<td>Unearned income</td>
<td>1,500</td>
<td>1,500</td>
</tr>
<tr>
<td>Membership transfer and other deposits</td>
<td>12</td>
<td>200</td>
</tr>
<tr>
<td><strong>Total Current Liabilities</strong></td>
<td><strong>18,188</strong></td>
<td><strong>17,560</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Long-term Liabilities:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Unearned income</td>
<td>500</td>
<td>2,000</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>23,899</td>
<td>24,228</td>
</tr>
<tr>
<td><strong>Total Long-term Liabilities</strong></td>
<td><strong>24,399</strong></td>
<td><strong>26,228</strong></td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td><strong>42,587</strong></td>
<td><strong>43,788</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Members’ Equity:</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Memberships</td>
<td>20,934</td>
<td>20,934</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>112,713</td>
<td>111,062</td>
</tr>
<tr>
<td><strong>Total Members’ Equity</strong></td>
<td><strong>133,647</strong></td>
<td><strong>131,996</strong></td>
</tr>
</tbody>
</table>

**Total $1 76,234**  

**$1 75,784**

### CONSOLIDATED STATEMENTS OF CASH FLOWS

Chicago Board Options Exchange, Incorporated and Subsidiaries  
For the Years Ended June 30, 2004 and 2003 (in thousands)

#### Cash Flows from Operating Activities:

- **Net Income**: $1,651  
- **Adjustments to reconcile net income to net cash flows from operating activities**:
  - Depreciation and amortization: $29,685
  - Deferred income taxes: $(329)
  - Equity in income of NSX: $(1,235)
  - Equity in loss of OneChicago: $4,359
  - Impairment of investment in affiliates: $1,763
  - Impairment of goodwill: $690

- **Changes in assets and liabilities**:
  - Accounts receivable: $536
  - Income taxes: $253
  - Prepaid medical benefits: $(3)
  - Other prepaid expenses: $1,449
  - Other current assets: $188
  - Accounts payable and accrued expenses: $1,437
  - Marketing fee payable: $(621)
  - Unearned income: $(1,500)
  - Membership transfer and other deposits: $(188)

**Net Cash Flows from Operating Activities**: $38,135

#### Cash Flows from Investing Activities:

- Capital and other assets expenditures: $(23,334)
- OneChicago investment: $(5,105)

**Net Cash Flows from Investing Activities**: $(28,439)

#### Net Increase in Cash and Cash Equivalents:

- **$6,797**

#### Cash and Cash Equivalents at Beginning of Year:

- **$20,558**

#### Cash and Cash Equivalents at End of Year:

- **$30,254**  
  - **$20,558**

**Supplemental Disclosure of Cash Flow Information**

- Cash paid for income taxes: $3,847  
  - **$3,875**

See notes to consolidated financial statements.
1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business – The Chicago Board Options Exchange (“the Exchange”) is a registered securities exchange, subject to oversight by the Securities and Exchange Commission. The Exchange's principal business is providing a marketplace for trading equity and index options.

Basis of Presentation - The consolidated financial statements include the accounts and results of operations of Chicago Board Options Exchange, Incorporated, and its wholly owned subsidiaries, Chicago Options Exchange Building Corporation, CBOE, LLC and CBOE Futures Exchange, LLC. Inter-company balances and transactions are eliminated.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts of assets and liabilities, disclosures of contingent assets and liabilities, and reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition – Transaction Fees revenue is considered earned upon the execution of the trade and is recognized on a trade date basis. Other Member Fees revenue is recognized during the period the service is provided. The Options Price Reporting Authority (“OPRA”) income is allocated based upon the market share of the OPRA members and is received quarterly. Estimates of OPRA's quarterly revenue are made and accrued each month. Regulatory Fees are predominately received in the month of January and are amortized monthly to coincide with the services rendered during the fiscal year.

Cash and Cash Equivalents - Cash and cash equivalents include highly liquid investments with maturities of three months or less from the date of purchase.

Accounts Receivable - Accounts receivable consist primarily of transaction, marketing and other fees receivable from The Options Clearing Corporation (“OCC”), and the Exchange's share of distributable revenue receivable from OPRA.

Investments in Affiliates - Investments in affiliates represent investments in OCC, OneChicago, LLC (“ONE”) and The National Stock Exchange (“NSX”), formerly known as the Cincinnati Stock Exchange. The investment in OCC (20% of its outstanding stock) is carried at cost because of the Exchange's inability to exercise significant influence. The Exchange accounts for the investments in NSX (68% of its total certificates of proprietary membership) and ONE (approximately 40% of its outstanding stock) under the equity method due to the lack of effective control over the operating and financing activities of each affiliate. Investments in affiliates are reviewed to determine whether any events or changes in circumstances indicate that the investments may be other than temporarily impaired. In the event of an impairment, the Exchange would recognize a loss for the difference between the carrying amount and the estimated fair value of the equity method investment.

Property and Equipment - Property and equipment are carried at cost, net of accumulated depreciation. Depreciation on buildings, furniture and equipment is provided on the straight-line method. Estimated useful lives are 40 years for the building and five to ten years for furniture and equipment. Leasehold improvements are amortized over the lesser of their estimated useful lives or the remaining term of the applicable leases.

Data Processing Software and Software Development Work in Progress - Data processing software and software development work in progress are capitalized in accordance with Statement of Position 98-1 “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use” and are carried at cost. Software development work in progress is reclassified to data processing software when the software is ready for its intended use. Data processing software is amortized over five to seven years using the straight-line method commencing with the date the software is put in service.

Goodwill – SFAS No. 142, “Goodwill and Other Intangible Assets,” requires that goodwill and separately identified intangible assets with indefinite lives no longer be amortized but reviewed annually (or more frequently if impairment indicators arise) for impairment. Separately identified intangible assets not deemed to have indefinite lives will continue to be amortized over their useful lives.

Income Taxes - Income taxes are determined using the liability method, under which deferred tax assets and liabilities are recorded based on differences between the financial accounting and tax bases of assets and liabilities.

Unearned Income - Unearned income represents amounts received by the Exchange for which the contracted services have not been provided.

Fair Value of Financial Instruments - SFAS No. 107, “Disclosures About Fair Value of Financial Instruments,” requires disclosure of the fair value of certain financial instruments. The carrying values of financial instruments included in assets and liabilities are reasonable estimates of their fair value.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

2. INVESTMENT IN THE NATIONAL STOCK EXCHANGE
The investment in NSX is accounted for using the equity method. Condensed financial statements of NSX as of and for the years ended June 30, 2004 and 2003 are as follows (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance Sheets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$25,268</td>
<td>$15,734</td>
</tr>
<tr>
<td>Securities available-for-sale</td>
<td>21,060</td>
<td>525</td>
</tr>
<tr>
<td>Other current assets</td>
<td>20,466</td>
<td>12,449</td>
</tr>
<tr>
<td>Long-term securities available-for-sale</td>
<td>8,560</td>
<td>11,508</td>
</tr>
<tr>
<td>Other long-term assets</td>
<td>3,878</td>
<td>4,862</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td><strong>79,232</strong></td>
<td><strong>45,078</strong></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>59,619</td>
<td>26,888</td>
</tr>
<tr>
<td>Deferred income taxes</td>
<td>751</td>
<td>982</td>
</tr>
<tr>
<td>Members’ equity</td>
<td>18,862</td>
<td>17,208</td>
</tr>
<tr>
<td><strong>Total liabilities and members’ equity</strong></td>
<td><strong>79,232</strong></td>
<td><strong>45,708</strong></td>
</tr>
<tr>
<td>The Exchange’s share of members’ equity</td>
<td>$11,647</td>
<td>$12,175</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Statement of Operations</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Transaction revenue</td>
<td>$4,226</td>
<td>$4,160</td>
</tr>
<tr>
<td>Other revenue</td>
<td>17,680</td>
<td>14,885</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td><strong>21,906</strong></td>
<td><strong>19,045</strong></td>
</tr>
<tr>
<td>Employee costs</td>
<td>4,406</td>
<td>2,342</td>
</tr>
<tr>
<td>Other expenses</td>
<td>15,678</td>
<td>13,948</td>
</tr>
<tr>
<td><strong>Total expenses</strong></td>
<td><strong>20,084</strong></td>
<td><strong>16,290</strong></td>
</tr>
<tr>
<td>Net income</td>
<td>1,822</td>
<td>2,755</td>
</tr>
<tr>
<td>The Exchange’s equity in net income</td>
<td>$1,235</td>
<td>$1,867</td>
</tr>
</tbody>
</table>

3. RELATED PARTIES
The Exchange collected transaction and other fees of $146.7 million and $129.0 million for the years ended June 30, 2004 and 2003, respectively, by drawing on accounts of the Exchange’s members held at OCC. For the years ended June 30, 2004 and 2003, respectively, the amount collected includes $14.1 million and $8.2 million of marketing fees (see note 9). The Exchange had a receivable due from OCC of $11.5 million and $11.9 million at June 30, 2004 and 2003, respectively.

The Exchange incurred rebillable expenses on behalf of NSX, for expenses such as employee costs, computer equipment and office space of $3.9 million and $3.7 million for the years ended June 30, 2004 and 2003, respectively. The Exchange had a receivable from NSX of $1.0 million and $890 thousand at June 30, 2004 and 2003, respectively.

OPRA is a committee administered jointly by the five options exchanges and is authorized by the Securities and Exchange Commission to provide consolidated options information. This information is provided by the exchanges and is sold to outside news services and customers. OPRA’s operating income is distributed among the exchanges based on their relative volume of total transactions. Operating income distributed to the Exchange was $14.5 million and $15.6 million for the years ended June 30, 2004 and 2003, respectively. The Exchange had a receivable from OPRA of $4.1 million and $4.1 million at June 30, 2004 and 2003, respectively.

The Exchange, the Chicago Mercantile Exchange Holdings, Inc. and the Board of Trade of the City of Chicago, Inc. are partners in ONE, a joint venture created to trade single stock futures. Certain ONE employees also have minority interests in the joint venture. ONE is a for-profit entity with its own management and board of directors, and is separately organized as a regulated exchange. The Exchange contributed $5.1 million and $3.4 million in capital to ONE during the years ended June 30, 2004 and 2003, respectively. The Exchange had a receivable due from ONE of $920 thousand and $1.0 million at June 30, 2004 and June 30, 2003, respectively. At June 30, 2004 and 2003, respectively, the Exchange’s equity in ONE was $2.9 million and $2.1 million.
4. LEASES
The Exchange leases office space with lease terms ranging from six months to five years. Rent expenses related to leases for the years ended June 30, 2004 and 2003 were $766 thousand and $735 thousand, respectively. Future minimum lease payments under these noncancellable operating leases are as follows at June 30, 2004 (in thousands):

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2005</td>
<td>776</td>
</tr>
<tr>
<td>2006</td>
<td>736</td>
</tr>
<tr>
<td>2007</td>
<td>112</td>
</tr>
<tr>
<td>2008</td>
<td>66</td>
</tr>
<tr>
<td>Total</td>
<td>1,690</td>
</tr>
</tbody>
</table>

5. EMPLOYEE BENEFITS
Eligible employees participate in the Chicago Board Options Exchange SMART Plan (the “SMART Plan”). The SMART Plan is a defined contribution plan, which is qualified under Internal Revenue Code Section 401(k). The Exchange contributed $3.7 million and $3.5 million to the SMART Plan for the years ended June 30, 2004 and 2003, respectively.

Eligible employees participate in the Supplemental Employee Retirement Plan (the “SERP Plan”). The SERP Plan is a defined contribution plan that is nonqualified by Internal Revenue Code regulations. The Exchange contributed $971 thousand and $788 thousand to the SERP Plan for the years ended June 30, 2004 and 2003, respectively.

The Exchange also has a Voluntary Employees’ Beneficiary Association (“VEBA”). The VEBA is a trust, qualifying under Internal Revenue Code Section 501(c)(9), created to provide certain medical, dental, severance, and short-term disability benefits to employees of the Exchange. Contributions to the trust are based on reserve levels established by Section 419(a) of the Internal Revenue Code. During fiscal 2004 and 2003, the Exchange contributed $2.6 million and $2.7 million, respectively, to the trust.

6. COMMITMENTS AND CONTINGENCIES
In September 2000, the Exchange reached an agreement in principle to settle a consolidated civil class action lawsuit filed against the Exchange and other U.S. options exchanges and certain market maker firms. The Exchange agreed to pay $16.0 million in three equal installments on or before October 16, 2000, July 1, 2001, and July 1, 2002. All payments have been made, and are being held in escrow pending approval of the settlement agreement by the U.S. District Court for the Southern District of New York.

The Exchange is currently a party to various legal proceedings. Litigation is subject to many uncertainties, and the outcome of individual litigated matters is not predictable with assurance. After discussions with counsel, it is the opinion of management that the outcome of such matters will not have a material adverse impact on the consolidated financial position, results of operations or cash flows in the Exchange.

In June 2004, the Exchange was notified of an investigation by the U.S. Department of Justice’s (“DOJ”) Antitrust Division “to determine whether there is, has been, or may be a violation of Section 1 of the Sherman Act, 15 U.S.C. § 1, by conduct, activities or proposed action of the following nature: product allocation agreement between the American Stock Exchange, LLC (AMEX) and the CBOE.” The Exchange is complying with the DOJ’s investigation. The Exchange is unable to predict the outcome of the DOJ’s investigation or whether such outcome will have a material financial statement impact.

7. INCOME TAXES
A reconciliation of the statutory federal income tax rate to the effective income tax rate, for the years ended June 30, 2004 and 2003, is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statutory federal income tax rate</td>
<td>34.0%</td>
<td>35.0%</td>
</tr>
<tr>
<td>State income tax rate, net of federal income tax effect</td>
<td>4.8</td>
<td>4.7</td>
</tr>
<tr>
<td>Other permanent differences, net</td>
<td>(1.0)</td>
<td>5.1</td>
</tr>
<tr>
<td><strong>Effective income tax rate</strong></td>
<td><strong>37.8%</strong></td>
<td><strong>44.8%</strong></td>
</tr>
</tbody>
</table>

At June 30, 2004 and 2003, the net deferred income tax liability approximated (in thousands):

<table>
<thead>
<tr>
<th></th>
<th>2004</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax assets</td>
<td>$ 10,940</td>
<td>$ 11,369</td>
</tr>
<tr>
<td>Deferred tax liabilities</td>
<td>34,839</td>
<td>35,597</td>
</tr>
<tr>
<td><strong>Net deferred income tax liability</strong></td>
<td><strong>$ 23,899</strong></td>
<td><strong>$ 24,228</strong></td>
</tr>
</tbody>
</table>

Deferred income taxes arise principally from temporary differences relating to the use of accelerated depreciation methods for income tax purposes, capitalization of software, licensing fees, funding of the VEBA trust and undistributed earnings from the Exchange's investment in NSX.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

8. IMPAIRMENT OF ASSETS

Impairment Charge for NSX – As is necessary under APB 18, which requires an adjustment to the carrying value of an asset when there is a decline (other than temporary) in the value of an asset that causes its current fair market value to be less than the carrying amount, the Exchange determined in the year ended June 30, 2004 that the value of its equity investment in NSX was impaired by $1.8 million and consequently lowered the value of its investment to reflect the estimated fair market value of its ownership interest in NSX. The fair market value of the investment was based on the sale price for 153 (94% of its current investment) of the NSX certificates of proprietary membership it currently owns (see note 10). Management believes this sale price is a basis for approximating the fair value of its investment in NSX.

Impairment Charge for New York Stock Exchange (NYSE) Options Program Goodwill – The Exchange purchased the NYSE options program in 1997. SFAS No. 142, “Goodwill and Other Intangible Assets,” requires that goodwill and separately identified intangible assets with indefinite lives no longer be amortized but reviewed annually (or more frequently if impairment indicators arise) for impairment. As a result of its review of goodwill, the Exchange recorded $690 thousand of impairment of other assets due to an increase in competition and the April 2004 expiration of the options trading permit program. The impairment review included an estimate of fair value of the intangible asset based on the expected present value of future cash flows ($698 thousand). No other changes in the carrying balance of goodwill occurred during years ended June 30, 2004 and 2003.

9. MARKETING FEE

Effective June 2, 2003, the Exchange re-instituted a new marketing fee program. As of June 30, 2004 and 2003 amounts held by the Exchange on behalf of others included accounts receivable balances of $1.0 million and $687 thousand, respectively.

10. SUBSEQUENT EVENTS

On April 19, 2004, the membership voted in favor of a proposal to initiate a purchase offer for a significant number of Chicago Board of Trade (“CBOT”) exercise rights. The Exchange has entered into a secured four-year term loan agreement providing for borrowings up to $50.0 million for the purchase of CBOT exercise rights. Borrowings under the agreement bear interest based on LIBOR or prime interest rates. The loan agreement includes covenants requiring the Exchange to maintain certain net worth and financial ratios. To date, no funds have been drawn on this line of credit.

On August 10, 2004, the Board of Directors of NSX approved the purchase of 153 (94%) of the NSX certificates of proprietary membership currently owned by the Exchange. The Exchange's Board of Directors approved the sale on September 14, 2004. Certificates of proprietary membership will be surrendered and NSX will pay the Exchange a total of $11 million over a period of four years on the anniversary of the closing date. The present value of the sale price is $10.7 million. The Exchange will ultimately retain nine certificates of proprietary membership (10% of the total certificates of proprietary membership). After the fourth anniversary of the closing date, the Exchange will account for its remaining investment in NSX on the cost basis.

INDEPENDENT AUDITORS’ REPORT

To the Board of Directors and Members of the Chicago Board Options Exchange, Incorporated:

We have audited the accompanying consolidated balance sheets of the Chicago Board Options Exchange, Incorporated and subsidiaries (the “Exchange”) as of June 30, 2004 and 2003, and the related consolidated statements of income and retained earnings and of cash flows for the years then ended. These financial statements are the responsibility of the Exchange's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of The National Stock Exchange (“NSX”), formerly the Cincinnati Stock Exchange, for the years ended June 30, 2004 and 2003, the Exchange's investment in which is accounted for by use of the equity method. The Exchange's equity of $11.6 million and $12.2 million in the NSX's net assets at June 30, 2004 and 2003, respectively, and of $12 million and $19 million in that Exchange's net income for the respective years then ended are included in the accompanying financial statements. The financial statements of NSX were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for NSX, is based solely on the report of such other auditors.

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 and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of the other auditors, such consolidated financial statements present fairly, in all material respects, the financial position of the Exchange and its subsidiaries at June 30, 2004 and 2003, and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

October 12, 2004
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American Stock Exchange
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EVEREN Capital Corporation and EVEREN Securities, Inc.
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Cornerstone Partners
General Partner
Fugue
General Partner
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Associated Options, Inc.
At-Large Director

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Knight Financial Products
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Fidelity Investments
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Partner
Sidley Austin Brown & Wood
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The Commercial Club of Chicago
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General Counsel and Secretary
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Federal Reserve Board
Dean
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Chicago Board Options Exchange
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Business and Finance
Northwestern University
Public Director

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Market Maker
Wilkinson Management, LLC
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Office of the Chairman

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William J. Brodsky
Edward T. Tilly
From left: Thomas A. Petrone, Stuart J. Kipnes, Robert J. Birnbaum, Robert A. Rosholt, R. Eden Martin, Samuel K. Skinner


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Thomas Stotts

EXECUTIVE OFFICERS AND STAFF OFFICIALS

EXECUTIVE
William J. Brodsky
Chairman and Chief Executive Officer

Edward T. Tilly
Vice Chairman

Edward J. Joyce
President and Chief Operating Officer

BUSINESS DEVELOPMENT
Edward L. Provost
Executive Vice President

Thomas A. Brady
Vice President
Member Trading Services

Daniel R. Hustad
Vice President
Market Quality Assurance and DPM Administration

Matthew T. Moran
Vice President
Institutional Marketing

Debra L. Peters
Vice President
The Options Institute

William J. White, Jr.
Vice President
Member Trading Services

CBOE FUTURES EXCHANGE
Patrick Fay
Managing Director

CORPORATE COMMUNICATIONS
Carol E. Kennedy
Vice President

CORPORATE PLANNING AND RESEARCH
Richard G. DuFour
Executive Vice President

Joseph Levin
Vice President
Research and Product Development

FINANCE AND ADMINISTRATION
Alan J. Dean
Senior Vice President and Chief Financial Officer

Donald R. Patton
Controller and Vice President Accounting

James P. Roche
Vice President
Market Data Services

Deborah Woods
Vice President
Human Resources

LEGAL
Joanne Moffic-Silver
General Counsel and Corporate Secretary

Arthur B. Reinstein
Deputy General Counsel

J. Patrick Sexton
Assistant General Counsel

REGULATORY SERVICES
Timothy H. Thompson
Senior Vice President and Chief Regulatory Officer

Douglas Beck
Vice President
Market Regulation

Lawrence J. Bresnahan
Vice President
Financial and Sales Practice Compliance

Richard Lewandowski
Vice President
Regulatory Services

Margaret Williams
Vice President
Regulatory Development

SYSTEMS
Gerald T. O'Connell
Executive Vice President and Chief Information Officer

James J. Neceda
Vice President
Systems Development

Mark S. Novak
Vice President
Chief Technology Officer

Larry L. Pfaffenbach
Vice President
Systems Planning

Gautam Roy
Vice President
Software

Curt Schumacher
Vice President
Chief Technology Officer

TRADING OPERATIONS
Philip M. Slucum
Senior Vice President

Gail Flagler
Vice President
Reporting Services

John T. Johnston
Vice President
Execution and Reporting Services

Thomas P. Knorning
Vice President
Trade Processing

Anthony Montesano
Vice President
Trading Systems Development

Michael Todorovsky
Vice President
Market Operations

Timothy T. Watkins
Vice President
Trading Systems Development
# Clearing Member Firms

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<td>ABN AMRO Sage Corporation</td>
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<td>Fimat USA Inc.</td>
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<td>First Clearing, LLC</td>
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<td>FOC Division of Spear, Leeds and Kellogg LP</td>
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<td>Goldman Sachs &amp; Co.</td>
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