

Edgar Filing: CBOE Holdings, Inc. - Form 10-Q

CBOE Holdings, Inc.
Form 10-Q
May 07, 2013
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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from _____ to _____

Commission File No. 001-34774

CBOE HOLDINGS, INC.

(Exact name of registrant as specified in its charter)

Delaware

20-5446972

(State or other jurisdiction of incorporation or organization)

(I.R.S. Employer Identification No.)

400 South LaSalle Street

60605

Chicago, Illinois

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code
(312) 786-5600

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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

Class

April 30, 2013

Unrestricted Common Stock, par value \$0.01

87,271,829 shares

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CERTAIN DEFINED TERMS

Throughout this document, unless otherwise specified or the context so requires:

•"CBOE Holdings" refers to CBOE Holdings, Inc. and its subsidiaries.

•"CBOE" or the "Exchange" refers to Chicago Board Options Exchange, Incorporated, a wholly-owned subsidiary of CBOE Holdings, Inc.

•"C2" refers to C2 Options Exchange, Incorporated, a wholly-owned subsidiary of CBOE Holdings, Inc.

•"CFE" refers to CBOE Futures Exchange, LLC, a wholly-owned subsidiary of CBOE Holdings, Inc.

•"CFTC" refers to the U.S. Commodity Futures Trading Commission.

•"FASB" refers to the Financial Accounting Standards Board.

•"GAAP" refers to Generally Accepted Accounting Principles in the United States.

•"OPRA" refers to the Options Price Reporting Authority.

•"Our exchanges" refers to CBOE, C2 and CFE.

•"SEC" refers to the U.S. Securities and Exchange Commission.

•"SPX" refers to our a.m. settled S&P 500 Index exchange-traded option.

•"We," "us," "our" or "the Company" refers to CBOE Holdings and its wholly-owned subsidiaries.

•"VIX" refers to the CBOE Volatility Index.

References to "options" or "options contracts" in the text of this document refer to exchange-traded securities options and references to "futures" refer to futures and securities futures contracts.

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FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involve a number of risks and uncertainties. You can identify these statements by forward-looking words such as "may," "might," "should," "expect," "plan," "anticipate," "believe," "estimate," "predict," "potential" or "continue," and the negative of these terms and other comparable terminology. All statements that reflect our expectations, assumptions or projections about the future other than statements of historical fact are forward-looking statements, including statements in the "Business" and "Management's Discussion and Analysis of Financial Condition and Results of Operations." These forward-looking statements, which are subject to known and unknown risks, uncertainties and assumptions about us, may include projections of our future financial performance based on our growth strategies and anticipated trends in our business. These statements are only predictions based on our current expectations and projections about future events. There are important factors that could cause our actual results, level of activity, performance or achievements to differ materially from that expressed or implied by the forward-looking statements. In particular, you should consider the risks and uncertainties described under "Risk Factors" in Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2012, Part II, Item 1A of this Quarterly Report on Form 10-Q and our other filings with the SEC.

While we believe we have identified material risks, these risks and uncertainties are not exhaustive. Moreover, we operate in a very competitive and rapidly changing environment. New risks and uncertainties emerge from time to time, and it is not possible to predict all risks and uncertainties, nor can we assess the impact of all factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

Some factors that could cause actual results to differ include:

- the loss of our right to exclusively list certain index option products;
- increasing price competition in our industry;
- compliance with legal and regulatory obligations;
- our ability to operate, monitor and maintain our systems or program them so that they operate correctly, including in response to increases in trading volume and order transaction traffic;
- decreases in the amount of trading volumes or a shift in the mix of products traded on our exchanges;
- legislative or regulatory changes;
- increasing competition by foreign and domestic entities;
- economic, political and market conditions;
- our ability to operate our business without violating the intellectual property rights of others and the costs associated with protecting our intellectual property rights;
- our ability to maintain access fee revenues;
- our ability to protect our systems and communication networks from security risks, including cyber-attacks;
- our ability to attract and retain skilled management and other personnel;
- our ability to maintain our growth effectively;
- our dependence on third party service providers; and
- the ability of our compliance and risk management methods to effectively monitor and manage our risks.

We caution you not to place undue reliance on the forward-looking statements, which speak only as of the date of this filing.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

CBOE Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Income
Three Months Ended March 31, 2013 and 2012

(in thousands, except per share amounts)	Three Months Ended March 31, 2013 2012 (unaudited)	
Operating Revenues:		
Transaction fees	\$99,145	\$84,835
Access fees	15,654	15,980
Exchange services and other fees	9,088	7,449
Market data fees	5,537	6,373
Regulatory fees	9,700	4,696
Other revenue	3,581	2,059
Total Operating Revenues	142,705	121,392
Operating Expenses:		
Employee costs	30,837	25,290
Depreciation and amortization	8,282	8,320
Data processing	4,516	4,899
Outside services	11,035	7,170
Royalty fees	13,169	11,191
Trading volume incentives	1,013	2,649
Travel and promotional expenses	2,064	2,167
Facilities costs	1,253	1,303
Other expenses	1,106	988
Total Operating Expenses	73,275	63,977
Operating Income	69,430	57,415
Other Income/(Expense):		
Investment income	4	23
Net loss from investment in affiliates	(725)	) (476)
Total Other Expense	(721)	) (453)
Income Before Income Taxes	68,709	56,962
Income tax provision	26,336	23,545
Net Income	42,373	33,417
Net income allocated to participating securities	(584)	) (554)
Net Income Allocated to Common Stockholders	\$41,789	\$32,863
Net Income Per Share Allocated to Common Stockholders (Note 4):		
Basic	\$0.48	\$0.37
Diluted	0.48	0.37
Weighted average shares used in computing income per share:		
Basic	87,272	88,146
Diluted	87,272	88,146

See notes to condensed consolidated financial statements

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CBOE Holdings, Inc. and Subsidiaries
 Condensed Consolidated Statements of Comprehensive Income
 Three Months Ended March 31, 2013 and 2012

(in thousands)	Three Months Ended March 31,	
	2013	2012
	(unaudited)	
Net Income	\$42,373	\$33,417
Comprehensive Income (Loss) - net of tax:		
Post retirement benefit obligation	(208	) (37
)
Comprehensive Income	42,165	33,380
Comprehensive income allocated to participating securities	(584	) (554
Comprehensive Income allocated to common stockholders	\$41,581	\$32,826

See notes to condensed consolidated financial statements

Table of ContentsCBOE Holdings, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets
March 31, 2013 and December 31, 2012

(in thousands, except share amounts)	March 31, 2013 (unaudited)	December 31, 2012
Assets		
Current Assets:		
Cash and cash equivalents	\$210,486	\$135,597
Accounts receivable—net allowances of \$353 and \$340	51,136	45,666
Marketing fee receivable	6,251	5,216
Income taxes receivable	481	11,717
Other prepaid expenses	6,335	4,146
Other current assets	735	567
Total Current Assets	275,424	202,909
Investments in Affiliates	14,221	14,270
Land	4,914	4,914
Property and Equipment:		
Construction in progress	89	89
Building	62,596	62,442
Furniture and equipment	266,120	263,155
Less accumulated depreciation and amortization	(256,528)	(251,642)
Total Property and Equipment—Net	72,277	74,044
Other Assets:		
Software development work in progress	5,204	4,370
Data processing software and other assets (less accumulated amortization - 2013, \$137,093; 2012, \$133,862)	37,585	38,351
Total Other Assets—Net	42,789	42,721
Total	\$409,625	\$338,858
Liabilities and Stockholders' Equity		
Current Liabilities:		
Accounts payable and accrued expenses	\$43,168	\$45,148
Marketing fee payable	6,842	5,808
Deferred revenue and other liabilities	23,780	1,084
Post-retirement medical benefits	90	110
Income taxes payable	11,872	—
Total Current Liabilities	85,752	52,150
Long-term Liabilities:		
Post-retirement medical benefits	2,174	1,794
Income tax liability	22,708	20,857
Other long-term liabilities	3,924	3,946
Deferred income taxes	20,341	20,989
Total Long-term Liabilities	49,147	47,586
Commitments and Contingencies		
Total Liabilities	134,899	99,736
Stockholders' Equity:		
Preferred stock, \$0.01 par value: 20,000,000 shares authorized, no shares issued and outstanding at March 31, 2013 or December 31, 2012	—	—
	913	913

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Unrestricted common stock, \$0.01 par value: 325,000,000 shares authorized;
 91,270,509 issued and 87,271,829 outstanding at March 31, 2013; 91,270,274 issued
 and 87,271,683 outstanding at December 31, 2012

Additional paid-in-capital	74,551	67,812	
Retained earnings	304,567	275,491	
Treasury stock at cost – 3,998,680 shares at March 31, 2013 and 3,998,591 shares at December 31, 2012	(104,204	) (104,201)
Accumulated other comprehensive loss	(1,101	) (893)
Total Stockholders' Equity	274,726	239,122	
Total	\$409,625	\$338,858	

See notes to condensed consolidated financial statements

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CBOE Holdings, Inc. and Subsidiaries
Condensed Consolidated Statement of Stockholders' Equity
(Unaudited)

(in thousands)	Preferred Stock	Unrestricted Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balance—January 1, 2013	\$—	\$913	\$67,812	\$275,491	\$(104,201)	\$ (893)	\$ 239,122
Cash dividends on common stock				(13,297)			(13,297)
Stock-based compensation			6,739				6,739
Purchase of unrestricted common stock from employees					(3)		(3)
Net income				42,373			42,373
Post-retirement benefit obligation adjustment—net of tax						(208)	(208)
Balance—March 31, 2013	\$—	\$913	\$74,551	\$304,567	\$(104,204)	\$ (1,101)	\$ 274,726

See notes to condensed consolidated financial statements

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CBOE Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows
Three Months Ended March 31, 2013 and 2012

(in thousands)	Three Months Ended	
	March 31, 2013	March 31, 2012
	(unaudited)	
Cash Flows from Operating Activities:		
Net income	\$42,373	\$33,417
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	8,282	8,320
Other amortization	29	22
Provision for deferred income taxes	(515)	(1,152)
Stock-based compensation	6,739	2,939
Loss on disposition of property	1	—
Loss on investment in affiliate	480	476
Impairment of investment in affiliate	245	—
Change in assets and liabilities:		
Restricted cash	—	(240)
Accounts receivable	(5,470)	(10,860)
Marketing fee receivable	(1,035)	(4,226)
Income taxes receivable	11,236	6,395
Prepaid expenses	(2,189)	(2,692)
Other current assets	(168)	124
Accounts payable and accrued expenses	(2,133)	(11,680)
Marketing fee payable	1,034	4,241
Deferred revenue and other liabilities	22,674	20,029
Post-retirement benefit obligations	(9)	(4)
Income taxes payable	13,723	18,234
Net Cash Flows provided by Operating Activities	95,297	63,343
Cash Flows from Investing Activities:		
Capital and other assets expenditures	(6,440)	(7,869)
Investment in affiliates	(676)	(394)
Other	8	—
Net Cash Flows used in Investing Activities	(7,108)	(8,263)
Cash Flows from Financing Activities:		
Payment of quarterly dividends	(13,297)	(10,745)
Purchase of unrestricted common stock from employees	(3)	(1)
Purchase of unrestricted common stock under announced program	—	(30,641)
Net Cash Flows used in Financing Activities	(13,300)	(41,387)
Net Increase in Cash and Cash Equivalents	74,889	13,693
Cash and Cash Equivalents at Beginning of Period	135,597	134,936
Cash and Cash Equivalents at End of Period	\$210,486	\$148,629
Supplemental Disclosure of Cash Flow Information		
Cash paid for income taxes	\$1,910	\$67
Non-cash activities:		
Unpaid liability to acquire equipment and software	907	2,453

See notes to condensed consolidated financial statements

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CBOE HOLDINGS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the three months ended March 31, 2013 and 2012

(Unaudited)

NOTE 1 —DESCRIPTION OF BUSINESS

CBOE Holdings, Inc. is the holding company for Chicago Board Options Exchange, Incorporated, C2 Options Exchange, Incorporated, CBOE Futures Exchange, LLC and other subsidiaries.

The primary business of the Company is the operation of markets for the trading of listed options contracts on three broad product categories: 1) the stocks of individual corporations (equity options), 2) various market indexes (index options) and 3) other exchange-traded products (ETP options), such as exchange-traded funds (ETF options) and exchange-traded notes (ETN options). We also offer futures products through our futures market.

The Company owns and operates three stand-alone exchanges, but reports the results of its operations in one reporting segment. CBOE is our primary exchange and offers trading for listed options through a single system that integrates electronic trading and traditional open outcry trading on our trading floor in Chicago. This integration of electronic trading and traditional open outcry trading into a single exchange is known as our Hybrid trading model. C2 is our all-electronic exchange that also offers trading for listed options, but with a different market model and fee structure than CBOE. CFE, our all-electronic futures exchange, offers futures on the VIX Index, as well as on other products. All of our exchanges operate on our proprietary technology platform known as CBOE Command.

NOTE 2 — BASIS OF PRESENTATION

These interim unaudited condensed consolidated financial statements have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosures of contingent assets and liabilities and reported amounts of operating revenues and expenses. On an ongoing basis, management evaluates its estimates, including those related to matters that require a significant level of judgment or are otherwise subject to an inherent degree of uncertainty. These estimates are based on management's knowledge and judgments, historical experience and observance of trends, information available from outside sources and various other assumptions that are believed to be reasonable under the circumstances. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of financial position, results of operations and cash flows at the dates and for the periods presented have been included. The results of operations for interim periods are not necessarily indicative of the results of operations for the full year.

NOTE 3 — SHARE REPURCHASE PROGRAM

On August 2, 2011, the Company announced that its board of directors had approved a share repurchase program that authorizes the Company to purchase up to \$100 million of its unrestricted common stock. On July 31, 2012, the Company announced that its board of directors had approved the repurchase of an additional \$100 million of its outstanding unrestricted common stock. This authorization is in addition to any amount remaining under the August 2011 authorization. The program permits the Company to purchase shares through a variety of methods, including in the open market or through privately negotiated transactions, in accordance with applicable securities laws. It does not

obligate the Company to make any repurchases at any specific time or situation.

From August 2011 through March 31, 2013, the Company purchased 3,707,424 shares of unrestricted common stock at an average cost per share of \$26.09, totaling \$96.7 million in purchases under the program.

The Company did not repurchase any shares under the program in the three months ended March 31, 2013.

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NOTE 4 — NET INCOME PER COMMON SHARE

The unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents, whether paid or unpaid, are participating securities and are included in the computation of net income per common share pursuant to the two-class method. Our restricted stock awards granted to officers, directors and employees qualify as participating securities.

The Company computes net income per common share using the two-class method, which is an allocation formula that determines the net income for common shares and participating securities. Under the authoritative guidance, the presentation of basic and diluted earnings per share is required for each class of common stock and not for participating securities. As such, the Company presents basic and diluted net income per share for its one class of common stock.

The computation of basic net income allocated to common stockholders is calculated by reducing net income for the period by dividends paid or declared and undistributed net income for the period that are allocated to the participating securities to arrive at net income allocated to common stockholders. Net income allocated to common stockholders is divided by the weighted average number of common shares outstanding during the period to determine basic net income per common share.

The dilutive effect of participating securities is calculated using the more dilutive of the treasury stock or the two-class method. Diluted net income per common share is calculated by dividing net income allocated to common stockholders by the sum of the weighted average number of common shares outstanding plus all additional common shares that would have been outstanding if the potentially dilutive common shares had been issued.

The following table reconciles net income allocated to common stockholders and the number of shares used to calculate the basic and diluted net income per common share for the three months ended March 31, 2013 and 2012:

(in thousands, except per share amounts)	Three Months Ended March 31,	
	2013	2012
Basic EPS Numerator:		
Net Income	\$42,373	\$33,417
Less: Earnings allocated to participating securities	(584	) (554
Net Income allocated to common stockholders	\$41,789	\$32,863
Basic EPS Denominator:		
Weighted average shares outstanding	87,272	88,146
Basic net income per common share	\$0.48	\$0.37
Diluted EPS Numerator:		
Net Income	\$42,373	\$33,417
Less: Earnings allocated to participating securities	(584	) (554
Net Income allocated to common stockholders	\$41,789	\$32,863
Diluted EPS Denominator:		
Weighted average shares outstanding	87,272	88,146
Dilutive common shares issued under restricted stock program	—	—
Diluted net income per common share	\$0.48	\$0.37

For the three months ended March 31, 2013, 1,124,933 shares of restricted stock were not included in the computation of diluted net income per common share because to do so would have an antidilutive effect.

NOTE 5 — STOCK-BASED COMPENSATION

Stock-based compensation is based on the fair value of the award on the date of grant, which is recognized over the related service period, net of estimated forfeitures. The service period is the period over which the related service is performed, which is generally the same as the vesting period.

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On February 6, 2013, the Company granted 390,272 shares of restricted stock to certain officers, directors and employees at a fair value of \$34.23 per share, the closing price of the Company's stock on the grant date. The shares have a three year vesting period and vesting accelerates upon the occurrence of a change in control of the Company. Unvested portions of the restricted stock will be forfeited if the officer, director or employee leaves the company prior to the applicable vesting date, except in limited circumstances.

For the three months ended March 31, 2013 and 2012, the Company recognized \$6.7 million and \$2.9 million of stock-based compensation expense, respectively. The three month periods ended March 31, 2013 and 2012 included \$3.2 million and \$0.2 million of accelerated stock-based compensation expense, respectively. The accelerated stock-based compensation expense, in 2013, is for certain executives due to provisions contained in their employment arrangements and, in 2012, departures from the board of directors. Stock-based compensation expense is included in employee costs in the condensed consolidated statements of income.

As of March 31, 2013, the Company had unrecognized stock-based compensation of \$23.7 million. The remaining unrecognized stock-based compensation is expected to be recognized over a weighted average period of 23.1 months.

The activity in the Company's restricted stock for the three months ended March 31, 2013 was as follows:

	Number of Shares of Restricted Stock	Weighted Average Grant-Date Fair Value
Unvested restricted stock at January 1, 2013	835,823	\$28.92
Granted	390,272	34.23
Vested	(93,137	) 34.22
Forfeited	(8,025	) 29.00
Unvested restricted stock at March 31, 2013	1,124,933	\$30.32

NOTE 6 — INVESTMENT IN AFFILIATES

At March 31, 2013 and December 31, 2012, the investment in affiliates was composed of the following (in thousands):

	March 31, 2013	December 31, 2012
Investment in OCC	\$333	\$333
Investment in Signal Trading Systems, LLC	11,388	11,437
Investment in IPXI Holdings, LLC	2,500	2,500
Investment in CBSX	—	—
Investments in Affiliates	\$14,221	\$14,270

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NOTE 7 — ACCOUNTS PAYABLE AND ACCRUED EXPENSES

At March 31, 2013 and December 31, 2012, accounts payable and accrued expenses consisted of the following (in thousands):

	March 31, 2013	December 31, 2012
Compensation and benefit-related liabilities	\$8,167	\$18,306
Royalties	12,234	10,529
Facilities	1,420	1,932
Legal	4,840	1,706
Accounts payable	3,120	735
Estimated liability related to SEC matter (See Note 13)	5,000	5,000
Linkage	1,771	1,116
Other	6,616	5,824
Total	\$43,168	\$45,148

NOTE 8 — MARKETING FEE

CBOE facilitates the collection and payment of marketing fees assessed on certain trades taking place at CBOE. Funds resulting from the marketing fees are made available to Designated Primary Market Makers and Preferred Market Makers as an economic inducement to route orders to CBOE. Pursuant to ASC 605-45, Revenue Recognition—Principal Agent Considerations, the Company reflects the assessments and payments on a net basis, with no impact on revenues or expenses.

As of March 31, 2013 and December 31, 2012, amounts assessed by the Company on behalf of others included in current assets totaled \$6.3 million and \$5.2 million, respectively, and payments due to others included in current liabilities totaled \$6.8 million and \$5.8 million, respectively.

NOTE 9 — DEFERRED REVENUE

The following table summarizes the activity in deferred revenue for the three months ended March 31, 2013 (in thousands):

	Balance at December 31, 2012	Cash Additions	Revenue Recognition	Balance at March 31, 2013
Other – net	\$1,084	\$2,086	\$(1,314)	) \$1,856
Liquidity provider sliding scale (1)	—	29,232	(7,308)	) 21,924
Total deferred revenue	\$1,084	\$31,318	\$(8,622)	) \$23,780

(1) Liquidity providers who prepay transaction fees, at a minimum, for the first two levels of the liquidity provider sliding scale are eligible to receive reduced fees on contract volume above 2,000,000 per month. The prepayment of 2013 transaction fees totaled \$29.2 million. This amount is amortized and recorded as transaction fees over the respective period.

NOTE 10 — EMPLOYEE BENEFITS

Employees are eligible to participate in the Chicago Board Options Exchange SMART Plan (“SMART Plan”). The SMART Plan is a defined contribution plan, which is qualified under Internal Revenue Code Section 401(k). The Company contributed \$1.0 million to the SMART Plan for each of the three months ended March 31, 2013 and 2012.

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Eligible employees may participate in the Supplemental Employee Retirement Plan (“SERP”), Executive Retirement Plan (“ERP”) and Deferred Compensation Plan. The SERP, ERP and Deferred Compensation Plan are defined contribution plans that are nonqualified by Internal Revenue Code regulations. The Company contributed \$0.5 million and \$0.4 million to the above plans for the three months ended March 31, 2013 and 2012, respectively.

The Company has a postretirement medical plan for certain current and former members of senior management. The Company recorded immaterial postretirement benefits expense for the three months ended March 31, 2013 and 2012.

NOTE 11 — INCOME TAXES

For the three months ended March 31, 2013 and 2012, the Company recorded income tax provisions of \$26.3 million and \$23.5 million, respectively. The effective tax rate for the three months ended March 31, 2013 and 2012 was 38.3% and 41.3%, respectively. The decrease in the effective tax rate for the three months ended March 31, 2013 compared to the prior year period is the result of the recognition of discrete items and the benefit of a lower apportionment by Illinois.

As of March 31, 2013 and December 31, 2012, the Company had \$21.1 million and \$19.5 million, respectively, of uncertain tax positions excluding interest and penalties, which, if recognized in the future, would affect the annual effective income tax rate. Reductions to uncertain tax positions primarily from the lapse of the applicable statutes of limitations during the next twelve months are estimated to be approximately \$3.8 million, not including any potential new additions.

Estimated interest costs and penalties, which are classified as part of the provision for income taxes in the Company’s condensed consolidated statements of income, were \$0.2 million for each of the three months ended March 31, 2013 and 2012. Accrued interest and penalties were \$1.6 million and \$1.4 million as of March 31, 2013 and December 31, 2012, respectively.

The Company is subject to U.S. federal tax, Illinois, New Jersey and New York state taxes and Washington D.C. taxes, as well as other local jurisdictions. The Company has open tax years from 2007 on for New York, 2008 on for federal and Illinois, and 2009 on for New Jersey and Washington, D.C. Specific line items for the 2008 tax year are being examined by the Internal Revenue Service and the Illinois Department of Revenue due to the filing of amended returns containing the recognition of certain credits and deductions. The Company's tax returns have been examined by the Internal Revenue Service through 2009 and the Illinois Department of Revenue through 2008. The Company is currently under audit by the Internal Revenue Service for 2010 and a limited issue focus examination for 2011. Additionally, the Company is under audit by the State of New York for the 2007 through 2009 tax years and the State of Illinois for the 2009 and 2010 tax years.

NOTE 12 — FAIR VALUE MEASUREMENTS

Fair value is the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. The fair value should be calculated based on assumptions that market participants would use in pricing the asset or liability, not on assumptions specific to the entity. In addition, the fair value of liabilities should include consideration of non-performance risk, including the Company’s own credit risk.

The Company applied FASB ASC 820, Fair Value Measurement and Disclosure (formerly, FASB Statement No. 157, Fair Value Measurements), which provides guidance for using fair value to measure assets and liabilities by defining fair value and establishing the framework for measuring fair value. ASC 820 applies to financial and nonfinancial instruments that are measured and reported on a fair value basis. The three-level hierarchy of fair value measurements

is based on whether the inputs to those measurements are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect the Company's market assumptions. The fair-value hierarchy requires the use of observable market data when available and consists of the following levels:

Level 1—Unadjusted inputs based on quoted markets for identical assets or liabilities.

- Level 2—Observable inputs, either direct or indirect, not including Level 1, corroborated by market data or based upon quoted prices in non-active markets.

Level 3—Unobservable inputs that reflect management's best assumptions of what market participants would use in valuing the asset or liability.

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The Company has included a tabular disclosure for financial assets that are measured at fair value on a recurring basis in the condensed consolidated balance sheet as of March 31, 2013 and December 31, 2012. The Company holds no financial liabilities that are measured at fair value on a recurring basis.

(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets at fair value:				
Money market funds	\$ 198,000	\$—	\$—	\$ 198,000
Total assets at fair value at March 31, 2013	\$ 198,000	\$—	\$—	\$ 198,000

(amounts in thousands)	Level 1	Level 2	Level 3	Total
Assets at fair value:				
Money market funds	\$ 126,000	\$—	\$—	\$ 126,000
Total assets at fair value at December 31, 2012	\$ 126,000	\$—	\$—	\$ 126,000

The Company, through DerivaTech Corporation, a wholly-owned subsidiary, acquired a 10.0% interest in IPXI Holdings, LLC ("IPXI") for \$2.5 million. The investment, measured at fair value on a non-recurring basis, is classified as level 3 as the fair value was based on both observable and unobservable inputs.

NOTE 13 — LEGAL PROCEEDINGS

As of March 31, 2013, the end of the period covered by this report, the Company was subject to the various legal proceedings and claims discussed below, as well as certain other legal proceedings and claims that have not been fully resolved and that have arisen in the ordinary course of business.

The Company reviews its legal proceedings and claims, regulatory reviews and inspections and other legal proceedings on an ongoing basis and follows appropriate accounting guidance when making accrual and disclosure decisions. The Company establishes accruals for those contingencies where the incurrence of a loss is probable and can be reasonably estimated, and we disclose the amount accrued and the amount of a reasonably possible loss in excess of the amount accrued, if such disclosure is necessary for our financial statements to not be misleading. The Company does not record liabilities when the likelihood that the liability has been incurred is probable, but the amount cannot be reasonably estimated, or when the liability is believed to be only reasonably possible or remote. The Company's assessment of whether a loss is reasonably possible or probable is based on its assessment of the ultimate outcome of the matter following all appeals.

Estimates of probable losses resulting from patent litigation involving the Company are inherently difficult to make, particularly when the Company's view of the case is significantly different than that expressed by the plaintiff. The Company has not recorded a liability related to damages in connection with these matters.

As of March 31, 2013, the Company does not think that there is a reasonable possibility that any material loss exceeding the amounts already recognized for these reviews, inspections or other legal proceedings, if any, has been incurred. While the consequences of certain unresolved proceedings are not presently determinable, the outcome of any litigation is inherently uncertain and an adverse outcome from certain matters could have a material effect on our earnings in any given reporting period.

Index Options Litigation

On November 15, 2006, CBOE, The McGraw-Hill Companies, Inc. ("McGraw-Hill") and CME Group Index Services, LLC (substituted for Dow Jones & Co.) ("Dow Jones") asserted claims in the Circuit Court of Cook County, Illinois against International Stock Exchange and its parent company ("ISE"), seeking a declaration to prevent ISE from offering SPX and DJX options and to prevent OCC from issuing and clearing such options. ISE filed a lawsuit on November 2, 2006 in the United States District Court for the Southern District of New York, seeking a declaration that the rights asserted by McGraw-Hill and Dow Jones are preempted by federal law. The New York action is

currently pending, but has been stayed in light of the Illinois action. The Illinois court has permanently restrained and enjoined ISE from listing or providing an exchange market for the trading of SPX and DJX options and enjoined OCC from issuing, clearing or settling the exercise of such ISE options. The Illinois Appellate Court affirmed the lower court's ruling on May 25, 2012 and the Illinois Supreme Court denied ISE's appeal of this decision. ISE filed a Petition for Certiorari with the U.S. Supreme Court on January 25, 2013.

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Patent Litigation

ISE -- '707

On November 22, 2006, ISE filed an action in the United States District Court for the Southern District of New York claiming that CBOE's Hybrid trading system infringes ISE's U.S. Patent No. 6,618,707 ("the '707 patent"). On January 31, 2007, CBOE filed an action in federal court in the Northern District of Illinois seeking a declaratory judgment that the '707 patent was not infringed, not valid and/or not enforceable against CBOE. The New York case was transferred to the Northern District of Illinois on August 9, 2007.

On March 14, 2013, ISE conceded to an adverse judgment in this trial and asked that the judge enter judgment for CBOE. ISE filed its notice of appeal in this matter with the Federal Circuit on April 12, 2013.

On August 15, 2012, C2 filed a declaratory judgment complaint against ISE in the United States District Court for the Northern District of Illinois alleging that the '707 patent is not valid, not infringed and not enforceable in light of decisions in the CBOE case involving the same patent. On April 10, 2013, the Court granted C2's motion to stay the case pending the outcome of the CBOE case.

ISE -- QRM

On November 12, 2012, CBOE brought suit against ISE in the United States District Court for the Northern District of Illinois alleging that ISE infringes three patents related to quote risk monitor (QRM) technology. CBOE has requested injunctive relief and monetary damages. On February 20, 2013, the court ruled that the case be transferred to the United States District Court for the Southern District of New York where it will proceed.

SEC Matter

As previously reported in the Company's periodic and annual filings, the staff of the SEC is investigating CBOE's compliance with its obligations as a self-regulatory organization under the federal securities laws. We continue to cooperate with the investigation and CBOE is conducting its own review of its compliance and regulatory programs and has modified those programs. We believe that any resolution of this matter will include a monetary penalty and will require CBOE to make additional changes to its compliance and regulatory programs and procedures. A resolution of this matter may also involve other remedies within the SEC's authority. The Company has recorded a liability of \$5.0 million related to this matter which is in accounts payable and accrued expenses in the condensed consolidated balance sheet for the three months ended March 31, 2013. We believe that it is reasonably possible that the Company could incur a charge in connection with this matter of up to \$10 million, and any agreement will be subject to the approval by the Commissioners of the SEC. Therefore, there can be no assurance that the Company's negotiations with the SEC staff will result in a definitive agreement, and the amount of the monetary penalty upon final disposition of these matters may exceed the amount we have accrued. However, we believe that the likelihood of any additional monetary penalty in excess of the upper limit of the range set forth above is remote.

NOTE 14 — SUBSEQUENT EVENTS

The Company announced that its board of directors declared a quarterly cash dividend of \$0.15 per share. The dividend is payable June 21, 2013 to stockholders of record at the close of business on May 31, 2013.

On Thursday, April 25, 2013, a systems issue delayed the opening of options trading at CBOE from 8:30 a.m. until 12:00 p.m. CST. Trading at C2 and CFE opened as scheduled. The malfunction that impacted CBOE was an internal systems issue and not the result of any outside influence. After the issue was identified, corrective modifications were made to allow the exchange to open on Thursday. The Company does not believe the delayed opening of options trading at CBOE will have a material impact on the financial statements.

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CBOE HOLDINGS, INC. AND SUBSIDIARIES

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

The following discussion should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and the notes thereto, included in Item 1 in this Quarterly Report on Form 10-Q, and the audited consolidated financial statements in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, and as contained in that report, the information under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations." This discussion contains forward-looking information. Please see "Forward-Looking Statements" and Part II, Item 1A, "Risk Factors" for a discussion of the uncertainties, risks and assumptions associated with these statements.

RESULTS OF OPERATIONS

Three months ended March 31, 2013 compared to the three months ended March 31, 2012

Overview

The following summarizes changes in financial performance for the three months ended March