BME Business Areas

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BME in 2010 resumed earnings growth following two years in which the business model proved to be sound, but in which the prevailing trends in the company's main markets of revenues consisted of a generalised flight of savings into assets with less exposure to risk and a near-paralysis in merger and acquisition (M&A) activity.

Net profit rose by 2.7% from 2009, to €154.1 million, though it increased by 8.9% after stripping out one-off items in revenues and expenses in both years. These earnings, which include EBITDA of €223.1 million (up 6.3%), stemmed largely from a combination of two factors: on one hand, a recovery in revenues associated with the product trading business, especially Equities, and, on the other hand, a significant management effort aimed at reducing costs, which ultimately generated a 3.4-percent decrease in operating costs from 2009.

Revenues from trading accounted for approximately 55% of total Group revenues in 2010 (equity trading alone accounted for 43%). Trading thus increased its share of total revenues by 4 points from 2009 and accounted for 54% of profit. This heading includes figures reported for the Equities, Fixed Income and Derivatives business units, details of which will be provided later in this report. What's more, year-on-year combined expenses at these three business units dropped by 7.3%, far outpacing cost cutting at other company divisions. Including the Clearing and Settlement Unit, whose business is closely and primarily linked to trading volumes, the total weighting of these divisions as a share of BME's revenues and net profit approaches 80%.

By the end of 2010, BME's efficiency ratio stood at 31.6%, an improvement of 2.1 points on the previous year. In other words, for every 0.316 unit of cost, the company generates one unit of revenue. This represents a 20-point improvement over the sector average. Meanwhile, BME's return on equity (ROE) stood at 34.3% in 2010, an improvement of 1.8 points on 2009. This exceeds the sector average by more than 22 points.

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These numbers doubtless go a long way towards explaining the performance of the company's 2010 consolidated income statement. Despite the instability and tensions roiling financial markets, the Spanish stock market's security and liquidity once again served as an adequate channel for the slow awakening of investors' appetite for taking somewhat less conservative positions in a prevailing environment of distrust. BME has a robust business model, based on diversification of markets, products and services, as it enables BME to simultaneously safeguard the company's value while deploying the flexibility necessary to add emerging new business opportunities and a gradually improving economic climate to the value creation chain. Revenue not linked to volumes covered 102% of the cost base at year's end.

This balanced combination of products and prudent resource management geared towards ensuring adequate provision of services to investors, issuers and brokers while maximising shareholder returns has enabled BME to maintain an attractive and well-established dividend policy. BME since 2007 has paid shareholders an annual dividend of €1.972 per share, leaving its dividend payout at over 80%. Moreover, for 2010 the payout is expected to be 86%. That represents one of the highest payouts for any company listed on the IBEX 35 index. BME's market capitalisation ended the year at €2.597 billion.

Equities

BME's equities business is the company's main revenue stream. This area in 2010 contributed 43.7% of the Group's total revenue and 46.2% of its EBITDA through activities derived almost exclusively from the trading of shares, ETFs, warrants, certificates and preferred shares on its platforms. The relative weighting of the equities business rises further with the addition of revenue from the sale of licenses for the use of proprietary BME indices and annual issuer listing fees within the Information and Listing business units.

Summary of Activity Indicators, BME Markets and Indicators

Unit	Item	2010	2009	% change
Equities				
Stock market indices	IBEX 35	9,859.10	11,940.00	-17.43%
	IBEX 35 with dividends	18,598.80	21,360.10	-12.93%
	IBEX MEDIUM CAP	10,120.30	10,719.90	-5.59%
	IBEX SMALL CAP	5,985.50	7,327.60	-18.32%
	IBEX TOP DIVIDENDO	2,296.10	2,657.50	-13.60%
	FTSE4Good IBEX	9,021.50	10,628.90	-15.12%
	FTSE Latibex Top	5,498.70	5,012.30	9.70%
	FTSE Latibex Brasil	15,443.10	14,061.00	9.83%
Activity	Trading volume (million euros)	1,038,909	899,051	15.56%
	Number of trades	40,813,292	31,966,827	27.67%
	Shares traded (millions)	137,929	118,697	16.20%
	Average value per trade (euros)	25,455	28,124	-9.49%
	Capitalisation (millions of euros)	1,071,633	1,107,006	-3.20%
Fixed income				
	Trading volume (million euros)	3,958,086	3,901,881	1.44%
Listing				
	Investment flows channelled through stock exchange (million euros)	27,944	15,666	78.37%
	Listed on AIAF (nominal value in million euros)	223,444	388,576	-42.50%
Derivatives				
Futures	IBEX 35 futures (number of contracts)	9,860,262	8,585,281	14.85%
	Equity futures (number of contracts)	19,684,108	44,586,779	-55.85%
Options	IBEX 35 options (number of contracts)	3,072,418	4,357,260	-29.49%
	Equity options (number of contracts)	37,607,374	35,527,914	5.85%
	Open interest (number of contracts)	10,828,329	9,527,971	13.65%
Clearing and settlement				
	Number of transactions settled	41,689,706	34,822,132	19.72%
	Trading volume settled (daily average in billion euros)	319.8	337.8	-5.33%
	Nominal amount registered at year-end (billion euros)	1,563.80	1,512.80	3.37%

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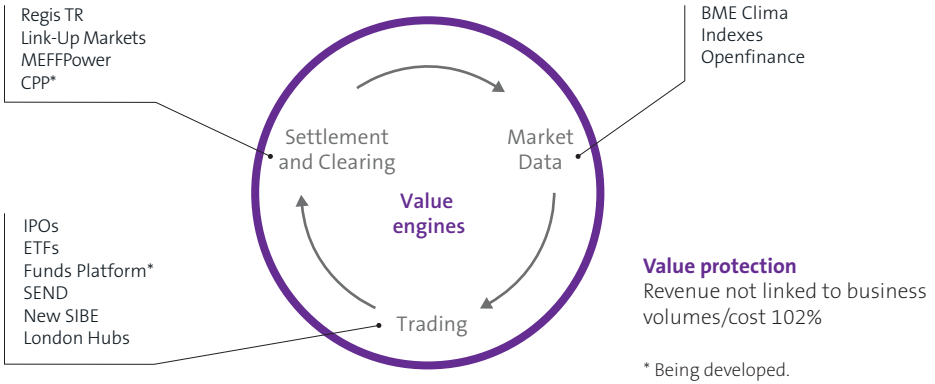
BME value creation activities

This business' weighting as a share of both Group revenue and profit rose by 3.5 points in 2010, thanks to an increase in funds obtained (up 11.2%) and significant cost containment of 5.9%, with costs reduced from €34.21 million in 2009 to €32.19 million in 2010. The bulk of the revenue generated from equities-related activities stemmed from earnings from securities traded on BME's trading platforms, mainly stocks. These revenues, from a company structure standpoint, are included in the Equities unit, and totalled €138.03 million in 2010. These earnings resulted in EBITDA of €105.83 million, an increase of 17.7% from 2009.

Apart from management efforts geared towards cost containment, improvement in this area mainly resulted from investor interest in securities of listed Spanish companies. This amply offset a negative impact on BME's commission income from declines in most traded securities due to generalised mistrust about the true state of the Spanish financial system.

Trading volumes for all equity securities totalled €1.03 trillion (equivalent to Spanish GDP), 15.6% higher than in 2009. Some 133,586 billion shares traded hands, an increase of 17% from 2008. Meanwhile, the number of trades climbed by 28% to an all-time high of 40.8 million trades (40.4 million in equities). Further historic highs were recorded in the number of orders processed in the market: 175 million orders, an increase of 86% from 2009, when the previous record for this indicator was set.



As in previous years, and despite three years of turmoil in financial markets, the Spanish securities market in 2010 remained exceptionally active and highly liquid. Spanish stock market turnover, a ratio between trading and the combined market cap of listed companies, in 2010 matched 2007 levels (a year of record-high trading volumes) at 205%. In other words, the value of shares trading hands in 2010 exceeded 2.05 times average monthly market cap.

Growth in trading volumes is proof that the Spanish stock market is weathering the challenges of the economic crisis and increased competition among the world's trading centres. In dollar terms, the Spanish stock market was the fourth-largest regulated market in Europe, and ranked No. 10 worldwide, according to the World Federation of Exchanges (WFE). Along with its German counterpart, the Spanish stock market registered the steepest percentage increase in trading volumes among Europe's leading regulated exchanges, and ranked No. 4 worldwide.

Among top European regulated markets, the Spanish stock market in 2010 registered the fastest year-on-year growth (15%) in the volume of shares trading hands on electronic trading platforms. In an environment of growing fragmentation among trading centres, the Spanish market accounted for nearly 99% of trading in Spain's listed companies, while for the decade as a whole, the value of stock trading in the Spanish market steadily boosted its weighting in Europe. This underlines and reflects at least three important issues: Spanish companies are robust and attractive to investors; the stock market offers opportunities for executing transparent, orderly expansion processes; the potential offered by appropriate and safe liquidity provision mechanisms for investment processes.

High liquidity in the stock market

This underscores the Spanish stock market's healthy investor community. Increased trading volumes are based on several factors: liquidity, attractive companies, market access... though they also reflect two further elements: the first linked to the economic cycle, as investors slowly but steadily return to the market to take somewhat riskier positions (portfolio reshuffling), and, second, what now appears to be a structural phenomenon of non-resident investors remaining highly active in our market. The latter investors account for slightly more than 60% of daily trading volumes and hold approximately 40% of the value of shares changing hands on the Spanish equity market (2009 data).

Bid/offer spreads (the difference between the best bid price and the best ask price) of listed Spanish shares have markedly narrowed in recent years, and systematically remain in very tight and efficient ranges, even when market conditions exacerbate volatility. The IBEX 35's average bid/offer spread hovered between 0.07% and 0.09% for most of 2010, ending the year at the top end of the range.

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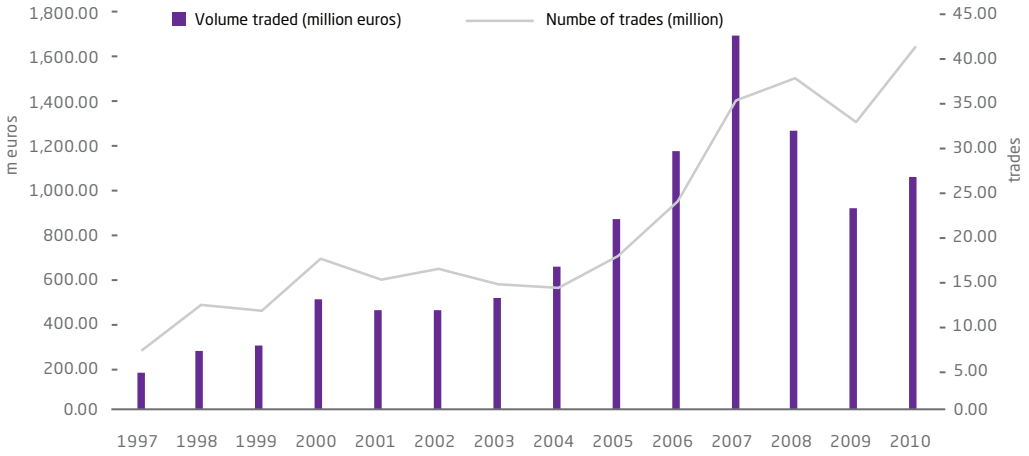
The Spanish platform's 2009 overhaul to enable a shift from two to four decimals in the quoting of certain securities undoubtedly continues to generate benefits in terms of market liquidity. BME made further progress in 2010 on bolstering and enhancing investor access to its transaction systems to address market needs, the demands of competition and the proliferation of algorithmic trading, particularly high-frequency trading. As part of this strategy, the company worked to improve its proximity services: in the fight against latency, these efforts were geared towards improving access to the Spanish stock market from London, Europe's chief financial centre. BME, through its technological subsidiary, Visual Trader Systems, in 2010 created two new access hubs for the Spanish stock market in London, equipped with the communications infrastructure needed to allow investors to connect with Spain's trading platforms for equities (SIBE) and derivatives (MEFF). The two new hubs, connected to Madrid by high-capacity, high-speed lines, will allow institutions in London to access the Spanish stock market in a safe, fast and reliable manner. The technology used in the connection guarantees the maximum data transfer speed (minimum latency).

Among other improvements, in order to increase capacity and enhance the flexibility of Equities trading on the Spanish stock market, BME announced in early 2010 that it would upgrade the SIBE trading platform to handle future growth in the market and the number of trades. The new platform will integrate trading in shares, ETFs, warrants, certificates and other products within a single scalable system. The system is tentatively scheduled to go live in the final quarter of 2011.

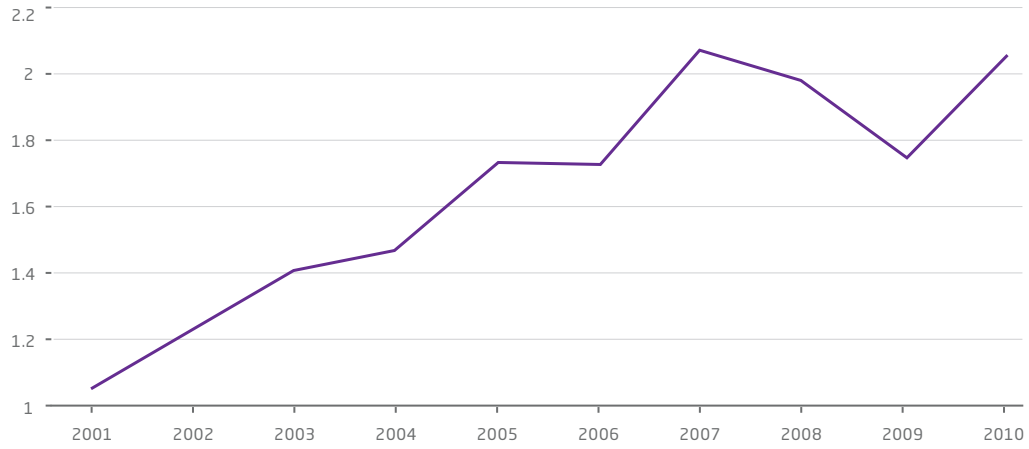
The volumes of shares trading hands in Spain's largest listed companies once again illustrated the market's liquidity. Shares of Santander, Telefónica and BBVA are among the top five most liquid stocks in the euro zone. Based on 2010 data for the pan-European Eurostoxx 50 index, which comprises the 50 largest listed stocks in the euro area, shares of these Spanish corporations rank first, second and fourth in terms of annual trading volume.

Shares traded on the Spanish Exchange (1997-2010)



Spanish stock exchange rotation rate (2001-2010)

The rotation rate measures the number of times the annual volume traded contains the average capitalisation for the same year.



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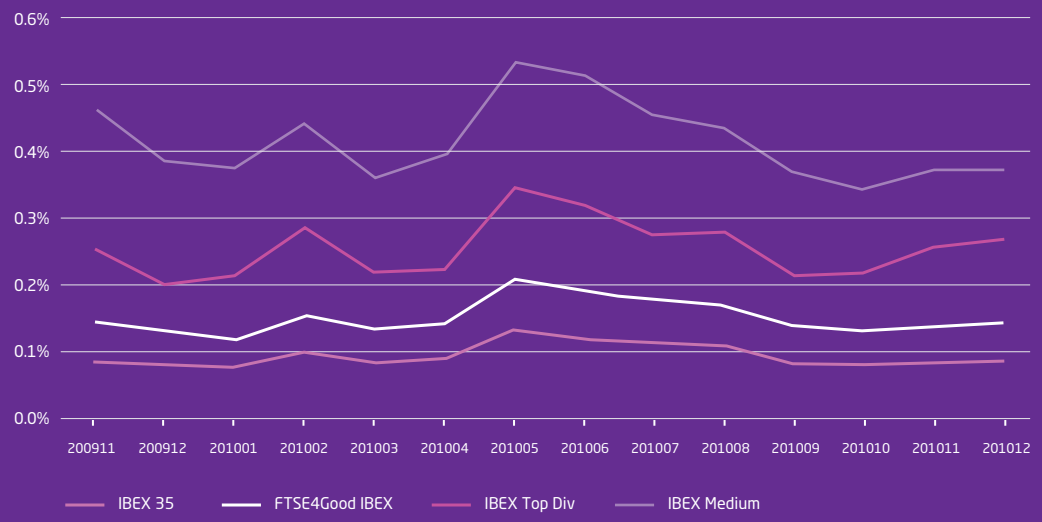
Liquidity: a cornerstone of the Spanish stock market

Trading volumes recorded in 2010 reflect that, despite the tensions, the market model has worked efficiently and liquidity remains one of the strongest points of the Spanish stock markets. In a context of growing fragmentation among trading centres, nearly 99% of trades in shares of listed companies were carried out on the Spanish stock market. Among the leading European regulated markets, the Spanish stock market in 2010 registered the fastest year-on-year growth (+15% in local currency and +8.1% in USD) in the volume of shares traded on electronic trading platforms. This is largely the result of two factors: effective market regulations backed by extremely high levels of transparency and access to trading systems that are efficient and adapted to the needs of market players, and 2) assets (listed shares, mainly) that are attractive for investors.

These factors are key because they foster confidence and liquidity - the basis of all security market operations. The positive combination of these two factors is why bid/offer spreads (the difference between the best bid price and the best ask price) of listed Spanish shares have markedly narrowed in recent years, and systematically remain in very tight and efficient ranges, even when market conditions exacerbate volatility. The IBEX 35's average spread hovered between 0.07% and 0.09% for most of 2010 (0.085% at the end of November). It hit 0.133% in May during the episode of great price volatility, to drop progressively over the rest of the year. For the IBEX 35's most liquid stocks (Santander, Telefónica, BBVA, Iberdrola and Repsol) the average spread in December was 0.05%-0.06%. The spread on the remaining stocks hovered mainly in the 0.10%-0.20% range.

2010 average spreads for IBEX indices
Monthly data



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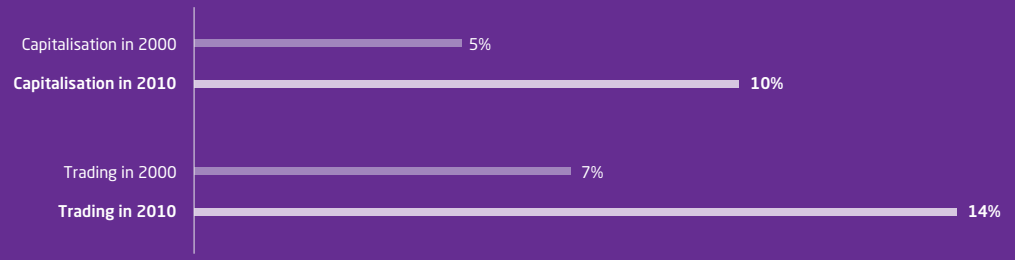
In regard to the quality of listed Spanish companies, the aforementioned data on the portion of trading volume contracted by non-resident investors is a clear indicator of international demand. . The market's liquidity was once again illustrated by the volumes of shares traded in Spain's largest listed companies. Shares of Santander, Telefónica and BBVA are among the top five most liquid stocks in the euro zone. Based on data for the pan-European Eurostoxx 50 index which comprises the 50 largest listed stocks in the euro area, shares of these Spanish corporations rank first, second and fourth in terms of 2010 annual trading volume.

This strong demand for shares of big Spanish issuers is a reflection of the leading positions held by these companies in their respective sectors in a context of strong international competition. Among other factors, these listed Spanish multinationals have had (and continue to have) access to a highly liquid stock market which has offered them growth opportunities that would be hard to find in other circumstances: most importantly, the ongoing and transparent pricing of the company's value (price setting). But also, the possibility of structuring operations to acquire large foreign companies in different areas using their listed shares as an exchange currency.

European trading and capitalisation - weighting of listed Spanish companies



2010 Ranking of trading in stocks belonging to the Paneuropean Eurostoxx 50 Index
(Ranking by trading volume)

Ranking	Security	Effective volume (euros)	Daily average (euros)	% weighting in the index at 31 December 2010
1	Banco Santander SA	268,255,138,097	1,047,871,633	4.18
2	Telefonica SA	253,855,565,513	991,623,303	4.28
3	UniCredit SpA	206,620,101,358	807,109,771	1.67
4	Banco Bilbao Vizcaya Argentaria SA	169,199,897,473	660,937,100	2.15
5	Deutsche Bank AG	123,518,067,625	482,492,452	2.31
6	ENI SpA	112,548,538,423	439,642,728	2.52
7	Siemens AG	106,658,560,380	416,635,001	5.06
8	Total SA	105,136,554,517	409,091,652	5.64
9	ArcelorMittal	98,804,146,869	384,451,933	1.67
10	BNP Paribas	92,921,868,238	361,563,690	3.06
14	Iberdrola SA	62,127,310,728	242,684,808	1.46
19	Repsol YPF SA	52,959,966,419	206,874,869	1.04

The effective volume traded is the sum of the volume traded in the regulated markets of origin and multilateral trading systems (MTFs).

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The appeal of listed Spanish companies

Factors fuelling investors' interest in Spanish firms listed on BME systems include these companies' buoyant earnings, their revenue streams' substantial international exposure, the generous dividend policy most of them offer, and, when compared with these advantages, their low relative prices in the past several months. By extension, major listed Spanish companies' sizeable international presence lends a positive global component to BME's businesses and generates benefits from diversification.

This geographic diversity among revenue sources at listed Spanish companies is very clear in the M&A realm. In nearly all developed economies, 2010 was not an especially prolific year for M&A activity. Reasons for this muted activity include reduced capital mobility and many companies' need for cash and to focus on stabilising their existing businesses. Nonetheless, in the latter half of 2010 M&A activity worldwide revived slightly, which, in the case of Spanish firms, endorsed their internationalisation efforts.

Earnings among listed companies confirmed the turning point hinted at in late 2009, as earnings in 2010 showed steady progress towards earnings recovery among listed companies as a group. At the close of the third quarter, profits reported by Spanish companies listed on the primary market stood at €37.29 billion, up 12.7% from the same period a year earlier.

Another element worth noting is the continuing powerful effect of dividends as a "cushion" or basic insurance against risk. By the end of 2010, the IBEX 35 TOTAL RETURN index was down 12.93% from a year earlier, outperforming the IBEX 35 by more than four percentage points. This appetite for dividend yield illustrates a near-constant trend in recent years: shareholder compensation on the Spanish stock market is very high and markedly outpaces that of competing foreign markets in relative terms. Companies paid shareholders €24.59 billion in gross compensation in 2010, primarily dividends.

Current P/E ratios remain relatively low (8.7x as of the end of 2010), underscoring a disparity between falling share prices and rising profits of listed companies throughout 2010. A comparison of the P/E ratios of leading bourses around the world shows that the Spanish stock market was the most attractive for another year running based on this relative measure. This situation, along with the Spanish equity market's continuing high average dividend yield and a ratio of market prices to book value which is substantially lower than the historic average, may go some way towards explaining the year's trading volumes.

Financial sector turmoil weighs on share prices

Securities transaction volumes also overcame declining share prices among listed Spanish firms and an associated drop in market capitalisation. In 2010 trading and share prices were plagued by the extreme vulnerability of the macroeconomic backdrop. Volatility whipsawed markets, particularly towards the middle of 2010, and in the last weeks of the year when it looked as though the hints of growth seen on an intermittent basis throughout the year would finally take hold. Market pressure on Spanish sovereign debt drove share prices to their lowest levels of the year, sending the IBEX 35 down 17.43% from a year earlier.

The IBEX 35 began 2010 with losses of 8.95% in the first quarter amid doubts, sparked by Greece's severe financial problems, about the health of European government finances. This uncertainty persisted in the second quarter as volatility exceeded 60%, prompting an IBEX 35 decline of more than 22%, the sharpest drop of any developed economy's benchmark index. In contrast, third-quarter share price recovery in the Spanish market outpaced that of other indices as uncertainty stemming from the sovereign debt crisis ebbed following the Spanish government's approval of a package of extraordinary austerity measures: restructuring the savings bank industry, labour reform and a commitment to major public spending cuts in the 2011 state budget, which came on the heels of tax hikes. This eased market volatility and encouraged a rebound in share prices. Sharp gains among bank shares in the third quarter (14%) following publication of the results of banking industry stress tests were clearly a deciding factor in the IBEX 35's bullish performance in the third quarter.

IPO of Nostrum, in November 2010.

The MAB market welcomes NEGOCIO.

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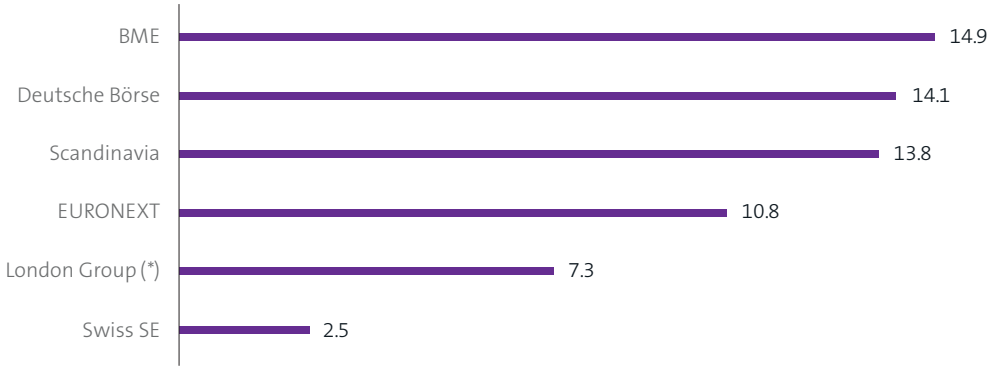
IPO of Enel Green Power.

The MAB market welcomes BODACLICK.

European stock markets
Percentage change of shares traded on electronic platforms (2010 vs 2009)



(*) Italian market trading volumes are included in the London Group
Source: WFE

However, in November a new outbreak of sovereign debt turmoil in Europe and confirmation that Ireland would require a bailout battered Spanish bank stocks, resulting in a 20-percent month-on-month decline in the banking sector index. By 30 November, shares in the Spanish banking industry were down 36% year-on-year, dragging the IBEX 35 with them given lenders' heavy weighting (30%) on the index.

Finally, the IBEX 35 rose by more than 6% in the first two days of December following a new announcement by the Spanish government of a package of measures and hints from the ECB that the institution might intervene in markets by buying debt of beleaguered countries. These announcements caused the spread between Spanish and German benchmark bonds to narrow by 250 basis points, after it sporadically flirted with highs of 315 points. This was crucial to reversing much of the year-on-year slump of late November (down 27.39%), bringing the IBEX 35's 2010 decline to just over 17%.

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Issuers and the risk posed by the fragmentation of the liquidity of their shares

The importance and size of a market and its companies are key but these factors cannot be disassociated from price setting and liquidity. In 2010, the need to embark on some of the reforms needed to improve the operations and structure of the stock markets which were brought into evidence by the crisis was a subject of intense debate in Europe and the whole world. Among these reforms: the need to prevent mass trading methods that are hidden or largely unregulated. A second key question arises relating to the topic we discuss in the chapter: a trading system that is fragmented among various centres with different market regulations and subject to different regulatory frameworks makes it difficult to ensure the correct and transparent setting of prices, and, consequently issuers run the risk that the markets will not be able to correctly perform their essential financing function.

The latest market events highlight how important it is for companies' shares to be traded in a stable and secure environment. It is clear that there is a need for regulations to also consider that issuers have the right to expect that market operations, at the very least, do not create distortions that damage the social and financial value contributed by their shares being admitted for trading on the secondary markets.

Instability, albeit caused by price jitters or by deficiencies in the regulations in force, is unquestionably a bad influence on financial markets in general, and securities markets in particular. A volatile and unclear environment has an extremely negative impact on prices and holds back corporate operations that generate value for the economy as a whole.

The US flash crash in May brought to light a large number of risks resulting from deficient market structures, but particularly, it brought to light risks deriving from fragmentation and the defenselessness of issuing companies when the price, or erratic performance, of their shares, has social and other systemic financial consequences.

At the EUROFI forum held last September, the chairman of BME and other leading representatives of stock markets and security market institutions, pointed out the risk that fragmentation would imply in terms of the financing offered by the stock markets to companies.

Companies want their shares to be traded on markets that can offer the funding they need. Logically, companies therefore seek to trade on markets which are adequately regulated, in cultural environments in which they feel comfortable and, of course, which are most ideally suited to their needs in terms of size and liquidity.

The decision to offer its shares on a specific market represents a milestone for any company. Nonetheless, given the proliferation of trading platforms and the obligation to passively accept prevailing legislation, it is extremely unfair that a company's shares be traded on a market that it has not chosen, under trading regulations with which it is not familiar, and subject to unwanted potential risks.

Fragmentation can (and is) prejudicing the size and importance of these markets, without offering anything of social or economic value in return. The risk that markets may lose size, importance and become less attractive as a major source of financing for companies is a very serious problem.

These are challenges that must be taken into consideration in the new regulations being developed. Challenges that could mark the future of companies and markets. These include making sure that stock market operations are not a distortion but a secure and positive factor in the setting of prices and liquidity of shares. One possible recommendation to avoid such undesirable consequences could be to require other systems that issuers have not voluntary selected to obtain express authorisation from issuers before they can trade in their shares.

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Stock market capitalisation and new investment flows

A sell-off in Spanish banks and a simultaneous increase in market risk in late 2010 depressed Spanish share prices, knocking nearly €86 billion off their market value. The total market cap of the Spanish bourse was €1.07 trillion, leaving the value of Spanish listed companies down 3% from December 2009.

Nevertheless, it is important to note that the market cap of the Spanish bourse remains €351.67 billion higher than the low point of recent years, recorded in February 2009, and that the value of Spanish companies is €79.74 billion higher on the same period.

Misgivings about the true extent of the Spanish economy's solvency and ability to successfully weather the fiscal adjustment challenges facing it weighed on the stock market, especially listed financial institutions. Shares of our banks, which consistently passed stress tests held several months ago, and whose still-sizeable earnings have dropped only slightly, were severely punished in 2010.

The MAB market welcomes AB-BIOTICS.

The Chairman of NEURON, on the day of the company's listing on MAB.

The VI MedCap Forum again brought together many companies and investors.

Representatives of Nostrum, on the day of the company's listing on MAB.

The LATIBEX Forum, a gateway between Europe and Latin America.

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The sell-off in Spain's financial and real estate stocks, among them the largest-market-cap companies on our market, made them the worst performers last year: their value plunged from €203 billion in December 2009 to €150.25 billion by the end of 2010, or 61% of the total value lost by listed Spanish companies. The consumer services sector was also battered, sinking 23% (a loss of €7.5 billion). These declines were partly offset by €7.57 billion in gains in the Consumer Goods business, in which Inditex was the main driver of growth throughout the year. The Spanish apparel group's shares soared 27.5% in 2010, making it Spain's No. 3 stock by market cap, leapfrogging BBVA and trailing only Telefónica and Santander.

Spain's listed companies lost 14.76% of their market value in 2010, vs. a decline of 17.43% in the IBEX 35. A main reason for this disparity is that market cap was bolstered by an incipient recovery in new issues, which accounted for €14 billion, most of which debuted on the MAB, and, in value terms, the flotation of Amadeus, which totalled €5.33 billion. Meanwhile, market cap also benefited from large capital increases, including an issue by BBVA for €5.06 billion, the second-biggest capital increase in monetary terms since 1993. Finally, a flotation by Italy's Enel Green Power added around €8 billion in new equity.

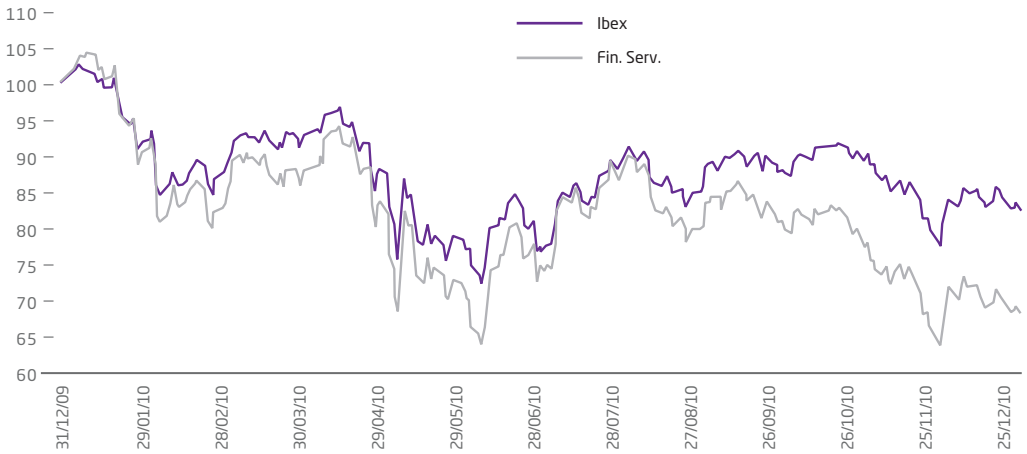
In total, new investment flows channelled by the Spanish stock market amounted to €27.94 billion in 2010 (up 78.4% from 2009). Of this total, newly-listed companies accounted for €13.78 billion, while capital increases by already-listed companies accounted for €14.16 billion. Company fundraising via cash-payment new share issues reached €11.60 billion, the highest volume in a decade.

Meanwhile, buoyant performance among Latin American companies listed on the Latibex, the Spanish trading system for Latin American securities, helped to offset some of the value lost in the Spanish bourse. Trading reflected emerging economies' success in riding out the crisis. The FTSE Latibex Top index boasted an annual return of 9.7% in 2010 and of nearly 235% since early 2002. The FTSE Latibex Brazil gained 9.8% in 2010 and has soared by 400% since 2004.

A total of 3,345 companies were listed on the Spanish stock market. This was a slight decrease from 2009, mainly due to the disappearance of several SICAVs.

As for the Spanish stock market's performance relative to foreign bourses, and according to the World Federation of Exchanges (WFE), since February 2009, the trough of the crisis in equity markets, the world's top 15 markets by capitalisation have recovered $19.6 trillion of the $31 trillion lost between October 2007 and February 2009. By the end of December 2010, the Spanish bourse, No. 14 in the world by market cap, was up 49% (€384.80 billion) from the lows reached during the worst of the crisis. By market value, companies listed in Spain accounted for nearly 10% of equity in Europe (5 points higher than at the start of the decade), and 2.13% worldwide, according to WFE data.

Performance of IBEX 35 and Financial and Real Estate sector services. 2010
Base 100 (30/12/2009)



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Performance of BME's Listing business

Though the scenario markedly improved in the second half of 2010, mixed performance in new share issues and the performance of securities prices, particularly stocks, eroded year-on-year growth in BME's earnings, at least in revenues and profit at the Listing Business Unit. This division also saw a slowdown in new issues of Private Fixed Income securities traded on AIAF (down 43% from 2009) and a drop in the outstanding balance of these products, a development we will address later in this report. The unit's revenues fell by 12% to €22.89 million. While the division cut costs by 3% (from €10.4 million to €10.09 million), EBITDA shrank by 18% to €12.8 million. The Listing business' weighting on BME's income statement fell by two points in 2010 and now represents 7.3% of revenues and 5.6% of profit.

Following upbeat expectations in late 2009 for M&A activity among listed companies, the hoped-for burst of deals did not materialise due to uncertainty surrounding the financial system and weak growth in developed countries. Nonetheless, forecasts indicate that continuing obstacles to accessing to bank financing and a conviction that debt levels must be lowered will tend to increase the share of financing raised in capital markets, thereby boosting the role of stock markets. Restructuring in the Spanish lending industry, particularly among savings banks, and the latter banks' plans to tap markets for their capital needs, plus further privatisations of government companies, bear witness to this scenario in coming months.

This forward-looking approach to equity has three pillars: the Alternative Equity Market (MAB), ETFs, or Exchange Traded Funds and the business and new products added to the warrants and certificates segment.

Start of trading of new ETFs on the Spanish stock exchange.

Fourth Anniversary of the ETF segment.

In 2010 the stock exchange continued providing financing.

Amadeus listed on the Stock Exchange in 2010.

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The MAB offers financial backing to small businesses with good products

In an environment characterised by tight credit, a logjam in funding mechanisms and a generalised flight of capital into safe-haven assets, in 2010 the Alternative Equity Market (MAB) offered a lifeline for many small businesses to continue funding their expansion plans.

While MAB has listed 10 members since it launched in 2009, it has increasingly become an alternative for mid- and small-sized businesses to obtain financing and thereby continue to roll out their business plans, expansion, diversification and internationalisation efforts. The MAB in 2010 provided a way into the market for industries that are absent from or underrepresented in the conventional bourse, such as biotechnology, with Neuron Biopharma and AB-Biotics making their debuts.

All companies joining this market financed themselves through capital increases. The funds raised in these deals ranged from Neuron Biopharma's €2.5 million to Bodaclick's €10 million. Imaginarium's IPO in 2009 remains the top fundraising deal in this market, generating €12 million. MAB's 10 companies obtained funds totalling €44 million euros in this market in 2010.

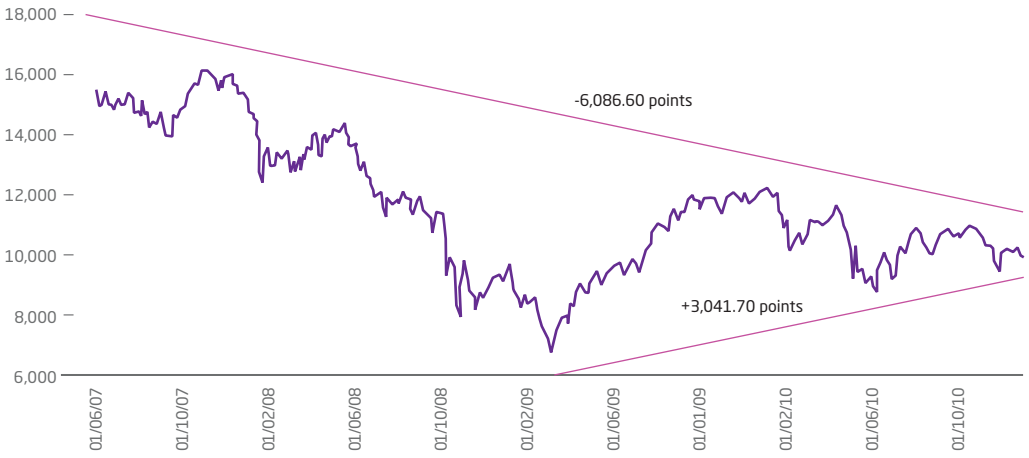
The Registry of Registered Advisors was established in June 2008 with 14 members ranging from securities brokerages and auditing and consulting firms to independent financial advisory groups. The number of Registered Advisors authorised to act as intermediaries between the company and the market totalled 28 by the end of 2010, after four new members joined that year. This interest highlights agents' confidence in the market and expectations for its growth potential.

ETFs become more popular: liquidity and a balance between yield, risk and cost

As ETFs likely registered their fastest-ever growth, 2010 will be remembered for the accomplishments made towards seeing this business fully developed in Spain. Transactions totalled €5.97 billion in 2010, an increase of 72% from 2009. The volume of trades likewise set a record: 63,154 trades, an increase of 24.3% from a year earlier. The market recorded 9,247 trades in May, an all-time monthly high for this still-young market. Further achievements included the number of traded ETFs, which total 65, an increase of 103% from 2009. The performance of assets under management was exceptional. ETFs, decoupled from the trend for cashing out conventional funds, tripled their assets under management in the past two years, from €9.88 billion in late 2008 to the current €37.38 billion.

A deciding factor in the spike in ETF trading in Spain was doubtless a June regulatory change allowing index-traded SICAVs. The change standardised treatment of all listed funds, regardless of whether they have a fund or corporate structure, by eliminating the tax withholding applied to the latter prior to the reform of CII regulations. Furthermore, regulators also approved the ability to use, in addition to fixed income and equity, any other underlying asset which the CNMV may expressly authorise.

IBEX 35 performance from the start of the financial crisis
November 2007 to December 2010



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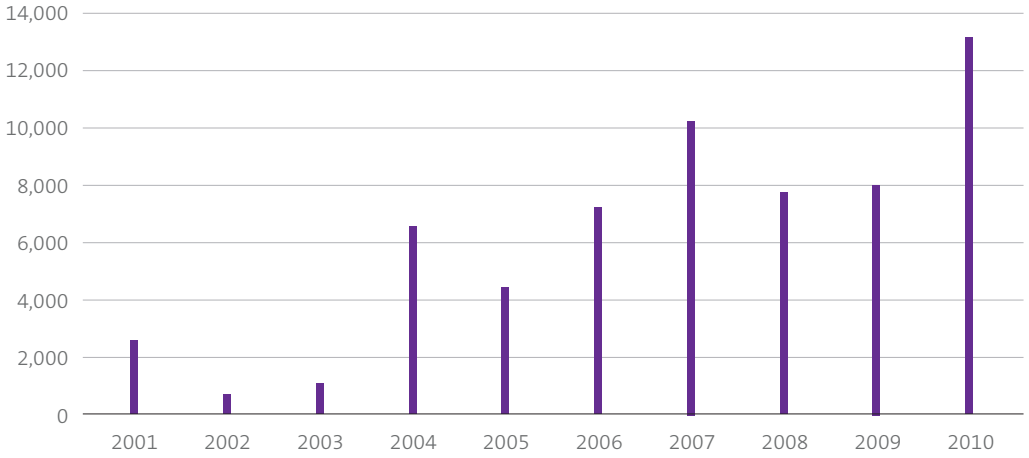
Effective amount of capital increases on the Spanish stock exchange excluding operations relating to concentration processes (2001-2010). Billion euros



New products traded on the warrants and certificates platform

The number of warrants, certificates and other products admitted to trading in 2010 reached 7,583, up 10% from 2009. With respect to the number of outstanding issues, at 31 December these amounted to 3,375, up from 2,910 at the end of the previous year.

As for volumes traded, warrants trading totalled €1.41 billion, a decrease of 15.75% from 2009. A highlight was the performance of turbo warrants, which amounted to €175 million, more than doubling the previous year's total of €86 million. A highlight of available underlying assets in the market was the broad array of assets on which these products are based. Warrants were traded on 121 different underlying assets in 2010.

This BME business line widened its range of traded products in 2010. Three series of Barclays Bank index linked notes (ILN) began trading in the first quarter. ILNs are a type of structured bond that can offer a specific return if they meet conditions established relating to the performance of the underlying index. A further two new product types have been traded since June: Bonus and Bonus Cap warrants. These varieties of warrants feature a barrier trigger mechanism, so that if the price of the underlying asset reaches or exceeds a certain threshold, the investor loses the right to an additional, pre-set yield known as a Bonus.

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The role of regulated stock markets and current internationalisation of listed Spanish companies

Inditex, Santander, Telefónica, Ferrovial, Repsol, Indra, BME, Técnicas Reunidas and Abertis are all examples of companies that were unknown outside Spain until up to a few years ago, however, they now top the world rankings in their respective industries by capitalisation. They make acquisitions in Europe and the Americas and are awarded projects in various geographical areas or have an extremely diversified network of sales points.

This historic leap has largely been made possible by the strong economic growth witnessed in Spain in the years prior to the crisis and the widespread opportunities for management, financing and investment made available to these companies as a result of their stock exchange listing. A study published recently in the Journal of Applied Corporate Finance entitled "How an IPO helps in M&A", demonstrates the multiple advantages that stock market listing has for companies wishing to grow through mergers and/or acquisitions. Following an analysis of the US companies that were listed between 1985 and 2004, the authors conclude that an IPO reduces the uncertainty of how to value a private company and allows its managers to know exactly what is to be gained in a potential acquisition.

The trend of virtually uninterrupted growth marked by Spanish companies in the last 25 years got underway between 1986 (when Spain joined the EU) and 2000 (when the euro was adopted). During these years large public companies were privatised and numerous new issuers joined the stock market, signalling a change of corporate focus in many companies as they shifted from holding defensive positions in an immature domestic market to an attitude more aligned with conquering external markets. However, the definitive change came in the first decade of this century and is still valid today, despite the slowdown caused by the shock that affected the capital markets after the financial crisis broke towards the end of 2007. Spanish direct foreign investment flows rose from an average of USD2,300 million between 1985 and 1995 to USD18,900 million in 1998, to peak at USD137,000 million in 2007 (almost 11% of total direct foreign investment in the EU for that year). The main destination of these flows was Latin America. A trend, which, as demonstrated by positive outlook for the region in the midst of the crisis, has been largely on target.

For many of the years leading up to the crisis, companies enjoyed favourable conditions: lending facilities, positive financing conditions and an unceasing flow of capital into Spain. Furthermore, listed Spanish multinationals have had (and continue to have) access to a highly liquid stock market which has offered them growth opportunities that would be hard to find in other circumstances. These include the possibility of structuring transactions to acquire

Comparison of trading data and market position in main listed companies

Company	Sector of activity	Market capitalisation		Percentage of total trading on the Spanish stock exchange
		Europe	the World	
ABENGOA	Construction and engineering	12	-	98.35%
ABERTIS	Motorways and railways	-	2	99.11%
ACCIONA	Construction and engineering	5	10	98.14%
ACERINOX	Steel	4	13	98.04%
ACS	Construction and engineering	3	3	98.27%
BANCO DE VALENCIA	Regional banking	1	30	100.00%
BANKINTER	Banking - various	36	65	98.02%
BBVA	Banking - various	8	20	99.26%
BME	Specialised finance	3	13	99.41%
CRITERIA	Multisector holdings	-	1	97.90%
ENAGAS	Gas	3	9	98.10%
FCC	Construction and engineering	10	19	97.89%
FERROVIAL	Construction and engineering	6	11	98.69%
GAMESA	Heavy electric machinery	11	-	98.43%
GAS NATURAL FENOSA	Gas	2	3	98.78%
GRIFOLS	Biotechnology	2	11	98.49%
IBERDROLA	Electricity	4	4	98.68%
IBERIA	Airlines	4	11	97.87%
INDITEX	Specialist retail	-	2	98.68%
INDRA	It consulting and other services	4	10	98.83%
MAPFRE	Multiline insurance	-	9	97.58%
POPULAR	Banking - various	25	48	98.72%
PROSEGUR	Alarms and security	-	4	100.00%
RED ELÉCTRICA	Electricity	9	29	97.96%
REPSOL	Integrated oil and gas	8	14	98.31%
SABADELL	Banking - various	30	56	97.89%
SACYR	Construction and engineering	13	-	98.68%
SANTANDER	Banking - various	2	4	99.11%
TECNICAS REUNIDAS	Oil and gas equipment and services	10	-	98.08%
TELECINCO	Television	6	-	98.09%
TELEFONICA	Integrated telecommunication services	1	2	99.11%
VISCOFAN	Processed meat and foods	11	-	99.99%
ZARDOYA OTIS	Industrial machinery	10	-	99.99%

Sources: MSCI Blue Book. Developed Markets (June 2010) and Bloomberg.

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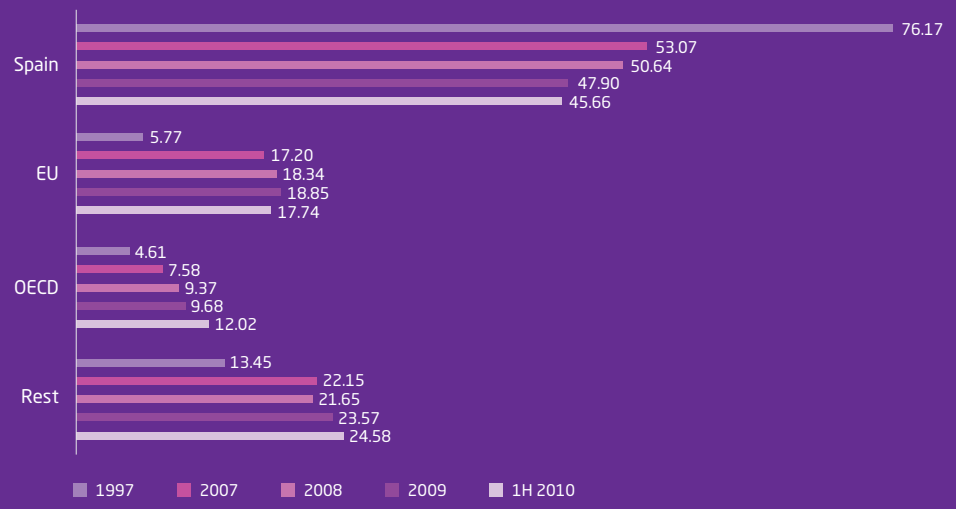
large foreign companies in different regions using their own listed shares as the exchange currency. It should be remembered that if Spain today has a large number of companies that are European and world references in their sectors, it is largely because these companies have made acquisitions abroad during the last few years.

The effect of this internationalisation of Spanish companies has been extremely positive and it has come to light in hardest moments of the virulent economic and confidence crisis that is currently plaguing the developed world. Even though their share prices have been penalised by belonging to a country, Spain, that is considered by the markets to have high sovereign risk, their financial statements, equity structure and key ratios have all remained consistent.

According to the latest data available for companies making up the IBEX 35 as a whole, external revenues are now higher than domestic revenues (54% vs 46% respectively in 1H10). 28% of sales revenues at these companies now derive from Latin America.

This data alone may not have a great deal of significance. However, it is extremely important if we consider that the UNCTAD's latest World Investment Report textually states that "despite the impact of the crisis on foreign direct investment (FDI) flows, the growing internationalisation of production has not slowed". In this report, many Spanish companies we mention in this article (mainly members of the IBEX 35) would rank among those classified as Transnational Companies or TNCs, precisely those whose subsidiaries, in the opinion of UNCTAD, registered a lower drop in sales and added value 2008 and 2009 than the aggregate for the world as a whole. According to the same report, "the contribution of foreign subsidiaries to world GDP hit a record high of 11% in 2009".

Revenue breakdown by market - IBEX 35 companies
(% of world total) (1997 - 1H 2010)



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Dividends: a bastion of profitability in the Spanish stock market

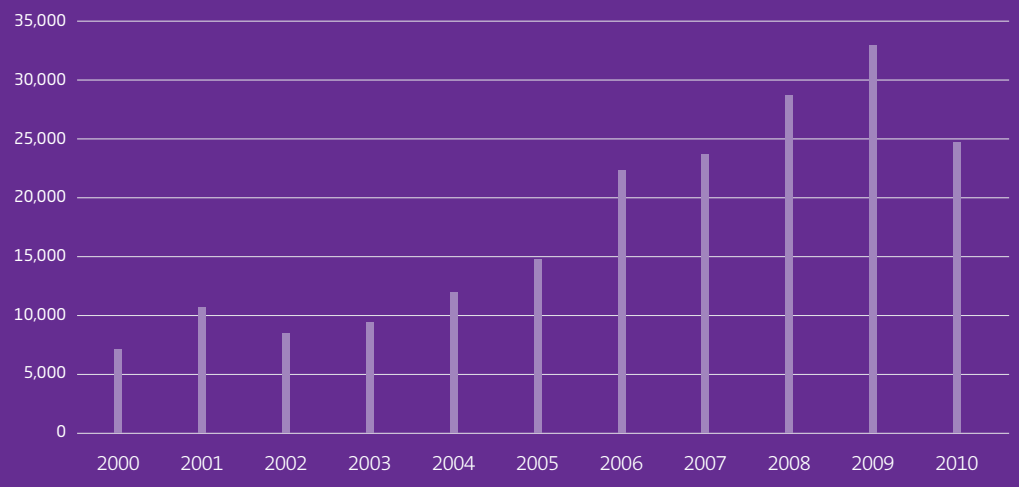
Investors' preference for a select group of listed Spanish companies is largely based on the recurrence of their earnings and the attention they place on maintaining their shareholder remuneration policies in order to pass onto the owners of the company, its shareholders, the results of their management. Undoubtedly, one of the most important factors for investors in the Spanish stock market has once again been the large number of companies that have paid significant dividends despite the difficult environment.

In 2010, listed companies remunerated shareholders a gross amount €24,593 million. Of this figure, €24,288 million took the form of dividends (cash or in kind) and €295 million were used to reimburse shareholders for their contributions via share premiums, reserves or a reduction of the nominal amount. Additionally, as it is still a relatively new concept, we would point out that among the instruments used to remunerate shareholders during this period, the use of payment in kind is gaining popularity, either through treasury shares or by issuing new shares or through capital increases. The total amount of dividends distributed in 2010 is still significant in historic terms even though it is 24% less than the figure distributed in 2009, because it reflects a commitment to shareholders that transcends the difficult and uncertain backdrop. Furthermore, the fall in the total amount distributed in 2010 is much lower than could be expected at times of deep financial crisis and activity such as the present. If we exclude the large extraordinary dividend paid by Endesa in March 2009 prior to joining Enel (€4,556 million), the total amount only falls by around 12% in 2010. Also, if we deduct the €1,945 million supposedly paid early by a group of companies in 2010 to prevent their shareholders from feeling the impact of the tax reform implemented on 1 January 2010, the "real" fall would be around 5%. We note that in January 2010 tax rate charged on savings income was increased from 18% to 19% up to the amount of €6,000 and to 21% from that amount on, with the first €1,500 exempt.

Two sectors increased their dividends compared to the previous year. Telecommunications, headed by Telefónica, with a 25% global increase, and the Consumer Goods sector where companies paid on aggregate 4% more in dividends than they did in 2009. In contrast, the financial sector, the hardest hit by the crisis from many standpoints, reduced its dividend payments by 9% throughout 2010. The exception is Criteria Caixacorp, that, in a year marked by strong investor relations activity, doubled the dividend paid in 2009 in 2010.

One of the most noticeable results of the decision taken by most companies to maintain dividend payments as one of their signs of identity is the overall increase in the payout ratio. Listed companies paid 47.03% of their net profit to shareholders in 2009, lower than the 55% paid against 2008 earnings but still very high in historic terms. Lastly, the combination of generally falling share prices and high shareholder remuneration in 2010 once again enabled the Spanish stock market to offer one of the highest dividend yields among the developed regulated markets. At the end of December this ratio stood at 6.2% for the major companies as a whole, almost 3 points above the historical average. In 2010, 20 companies reported a dividend yield higher than 5.45%, the average interest rate on 10Y treasury bills at the last auction in 2010 held on 16 December.

Dividends paid by listed companies
(Gross amount in million euros)



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Fixed Income

Due to the characteristics of these markets, this BME business line processes the greatest volumes of securities through BME systems, though it is the segment which contributes the least to the Group's global income statement. It accounted for 2.4% of revenues (€7.48 million) and 2.3% of EBITDA (€4.8 million). Nonetheless, despite major distortion in financial markets in 2010, heavy trading of bonds, corporate debt and government debt made a positive contribution to this Business Unit, whose profit climbed 27.9% from 2009. A highlight was cost containment (down 7.3%).

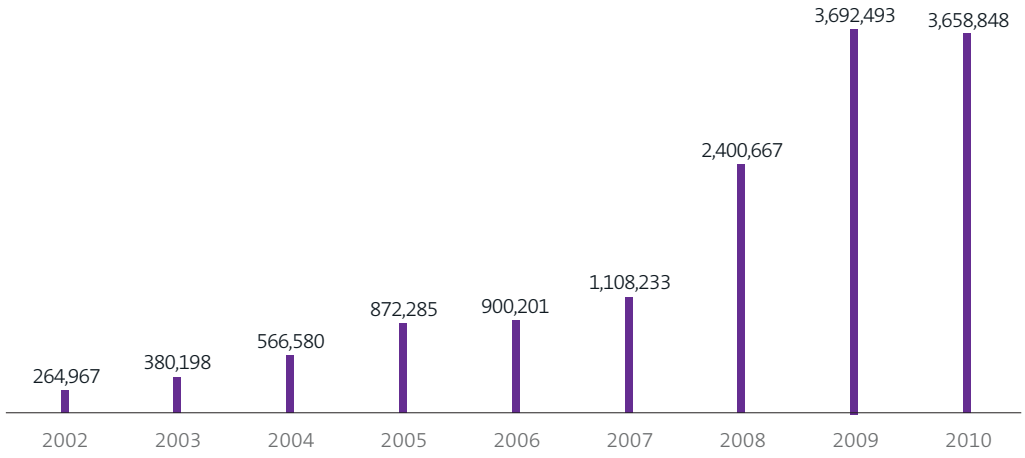
In Spain, tensions surrounding government debt were reflected in interest rates and, on the positive side, in trading volumes. According to data from the Spanish Public Debt Book-Entry System, which is overseen by the Bank of Spain and whose settlement activities are processed by Iberclear, trading volumes in 2010 reached historically high levels. This market's electronic trading activity, channelled primarily through BME's government debt trading e-platform, reflected this increase, with volumes totalling €236.59 billion, up 72% from 2009.

The corporate debt market was also reasonably buoyant in 2010, despite the challenging backdrop. The volume traded on AIAF, BME's corporate debt market, totalled €3.66 trillion, similar to the €3.7 trillion registered in 2009, which set a record for this market.

Among new developments in this business, and in line with BME's strategy for constantly upgrading its services, the SEND (Sistema Electrónico de Negociación de Deuda) electronic trading platform for equity instruments, aimed at retail investors, came into operation in April. It has had a considerable impact on price ordering, and individual investors report that they are very satisfied with it. Its trading volume is still not very significant in outright terms, but it continues to grow steadily. The creation of SEND, one of the world's first systems of its kind, represents significant progress towards improving transparency and liquidity in the Spanish corporate debt market and leaves the market a step ahead of potential EU rules governing fixed income.

SEND currently allows for simultaneous trades of up to 50 different issues placed among individual investors. The system will steadily add new issues reserved for retail investors. These assets include preferred shares, subordinated bonds and tax credit bonds, such as those issued to fund some toll roads. SEND in future may also include certain listed government debt assets, both Spanish and European, and other corporate debt instruments issued in other foreign markets.

Corporate Debt trading volumes
(million euros)



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As noted earlier, the prevailing instability and mistrust in credit markets in 2010 filtered through to bond markets, which suffered a greater sell-off in the primary market due, among other reasons, to the absence of measures to shore up and encourage the market through bond issues, unlike in 2009. Amid this environment, the total volume of new listings on the AIAF fixed income market was hampered by financial issuers' difficulties in accessing funds and by mergers among savings banks, which reduced the number of short- and long-term issuers.

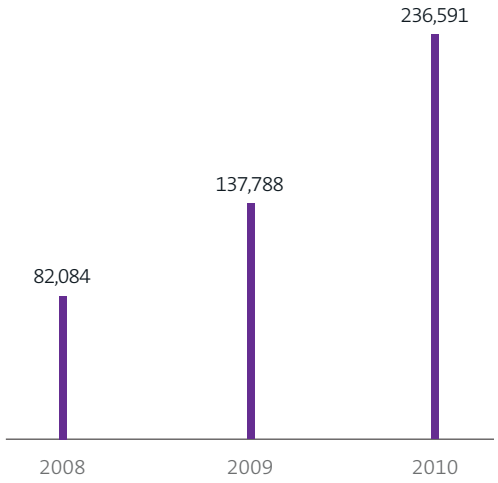
This tepid performance in listings was not helped by a steadily waning securitisation business, which was practically non-existent, and a drop in preferred share transactions following a change in its legal regime. Moreover, short-term debt volumes shrank, in both the primary and secondary markets, as cash dried up at investment funds and corporations, the main investors in these securities. However, in late 2010 the pace of this decline slowed.

On the other hand, the market in 2010 saw a sizeable increase in repo transactions, which became both an appealing alternative for raising cash and a safe haven for very short-term investment.

In sum, the primary market ended 2010 with total volume of new listings of €223.44 billion, leaving the outstanding balance of fixed income securities at €850.53 billion, only 2.4% lower than in 2009.

Lastly, private and public fixed income assets traded on the Spanish Stock Exchange's electronic fixed-income market and regional government bonds traded on the electronic trading platforms of the Barcelona, Bilbao and Valencia stock exchanges amounted to €62.65 billion in 2010, down 12.5% from the year before. More than 80% of the volume traded on the electronic fixed-income market consisted of convertible securities. These securities were traded daily, and their prices tracked the performance of their underlying assets. The outstanding balance of these issues was little changed from 2009, as market conditions did not encourage conversion.

Trading volumes on BME's Public Debt trading platform
Figures in billion euros (2008 - 2010)



SEND, a major step towards increasing transparency for the Debt Corporate market.

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Derivatives

Debate on a new regulatory framework for the financial sector returned derivatives markets to the spotlight in 2010. Data from the Bank for International Settlements confirm that an extraordinarily high proportion of these products are traded bilaterally and are not subject to standard trading rules or conditions (known as the over the counter, OTC, market), igniting concerns about the systemic risks they pose and the need to improve these markets' transparency. According to the BIS, in the first half of 2010 the outstanding notional volume of OTC derivative contracts worldwide totalled $600 trillion.

A trend continues for channelling these products into organised markets as a means of standardising and settling them through Central Counterparty Clearinghouses (CCP), as efforts continue to foster transparency in OTC transactions that are difficult to standardise using trade repositories.

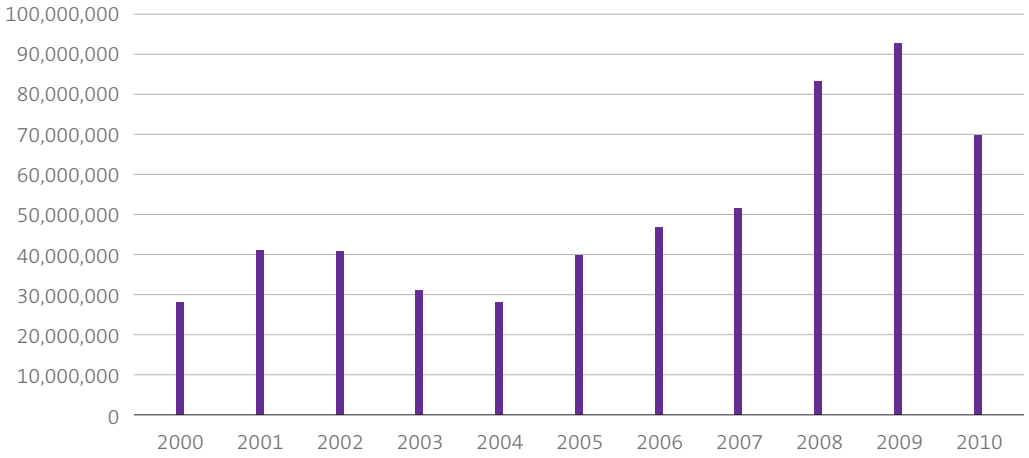
In this environment, investor performance in underlying securities traded as derivatives on BME's trading platform was highly satisfactory in 2010. Average volatility levels far exceeded the historical market average, with volatility spikes of around 60%, not seen since 2008. Implied annualised volatility on closing prices of IBEX 35 options to the nearest maturity is a good indicator of the volatility expected by investors at a given time, and its performance in the year clearly signalled a return of uncertainty to markets, which was particularly acute in Spain.

Highlights included trading in index-linked futures, which stood at 9.8 million contracts, up 14.8% on the previous year, and stock options trading, which totalled 37.6 million contracts (up 5.8%). However, total contracts traded stood at 70.2 million, down 24.5% from a year earlier due to a decrease in equity futures and IBEX 35 options.

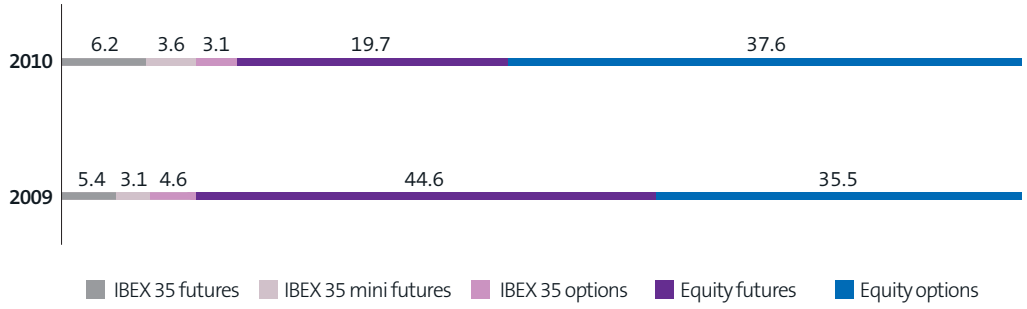
In nominal terms, some €789.11 billion were traded on this market, 12.9% more than in 2009. The number of transactions registered in 2010 amounted to 5.6 million, 17% more than in 2009. For another year, this business featured several historic highs. In November, the total open position hit an all-time high of 16.9 million contracts, as did the open position in equity options, with 14 million.

BME's main product, the IBEX 35 future, was the fastest growing instrument, rising by 16% from a year earlier to 6.2 million contracts. The number of share options remained very high at 37.6 million contracts (up 6% from a year earlier), a reflection of the growing shift of OTC operations to regulated markets and their greater use as a hedge and an instrument for leveraging market momentum. Finally, a record-high 3.5 million Mini IBEX 35 futures contracts, designed for individual investors, traded hands.

BME Futures and Options
Number of trades on equity products



Breakdown of BME futures and options trading
million contracts



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These transactions contributed operating revenues of €26.27 million in 2010 (up 1.6%) to BME's income statement. The reason for this growth is that, despite a slowdown in traded contracts as a whole, margins on IBEX 35-linked products (whose volumes climbed apace) outstripped those of non-IBEX 35 products (whose volumes dropped following record highs in 2009). The division made notable efforts to contain operating costs, which dropped by 11% to €10.85 million, as detailed in accounts at the Derivatives business unit, which accounted for 8.3% of Group revenues and 6.7% of profit. EBITDA totalled €15.42 million (up 12.8%).

One major change in 2010 will affect BME's derivatives business. On 16 October, Royal Decree 1282/2010 of 15 October was published in the BOE regulating official secondary markets for futures, options and other financial derivatives. The Royal Decree updates Royal Decree 1814/1991 and will allow the Derivatives unit to offer a wider range of products and services, expanded to encompass a greater number of underlying assets. MEFF submitted its Regulation for amendment to the Securities Commission in order to adapt it to Royal Decree 1282/2010, obtaining approval in December 2010 for enactment on 24 January 2011. The new regulation will allow the derivatives unit to broaden the range of services it offers, including central counterparty services for bilateral forward transactions on electricity in the Iberian market.

The BOLSA magazine offers a broad economic and financial content.

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The Spanish Derivatives Market poised for historic reform

The most significant factor for the Spanish derivatives market this year is the new legislation to regulate these official markets, implemented through Royal Decree 1282/2010 approved by the Council of Ministers on 15 October, in substitution of RD 1814/1991, regulating the official secondary markets for futures, options and other financial derivatives, and forming part of the future legal framework of MEFF.

This is fundamental legislation for MEFF as it authorises the creation of Futures and Options markets "with any underlying" and will allow MEFF to act as central clearing house not only for financial futures and options but also for other instruments, including repos.

In accordance with this new legislation, MEFF has drawn up a new Market Regulation, the main body of which dates from 1991, that has been submitted to the CNMV for approval and will allow various projects to start up next year (some of them are very close to completion).

These projects include the central clearing house for the Spanish electricity derivatives market, the OTC market that has been growing by more than 100% year-on-year since 2006, with a trading volume that is slated to exceed electricity consumption in Spain for the first time ever in 2010. In the first quarter of 2011 MEFF will launch a Central Counterparty service (CCP), with the commercial name MEFF POWER to enable Spanish electricity futures transactions and swaps traded on the OTC market to be registered in the MEFF clearing house.

It can therefore be said that for MEFF 2010 was a year of transition dedicated to dialogue with the supervisory authorities ahead of the new decree and regulation, as a basis for its future activities and legislative support, that will allow new services and products to come onto the market and allow it to compete on equal terms with other markets and other central counterparty houses.

It will also attract new resident and non-resident members and clients in the various spheres in which MEFF will operate.

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Business Areas

Clearing and Settlement

This BME business area contributed 23.9% of the Holding's revenue and 26.8% of EBITDA in 2010. This makes subsidiary Iberclear the second largest contributor in the company's overall business structure. The bulk of the work relates to post-trading processes, so the performance of this business area in the year was in line with the levels of activity in the areas related to fixed income and equity trading processes and products.

Equity settlements by Iberclear rose 17.5% to €4.08 billion daily, compared to an average of €3.47 billion in 2009. The number of transactions settled also grew by an average of 34.1% on the previous year, for a monthly average of 2.79 million trades. At the end of 2010, a total of 41.7 million transactions were settled, a 19.7% increase on the previous year's figure.

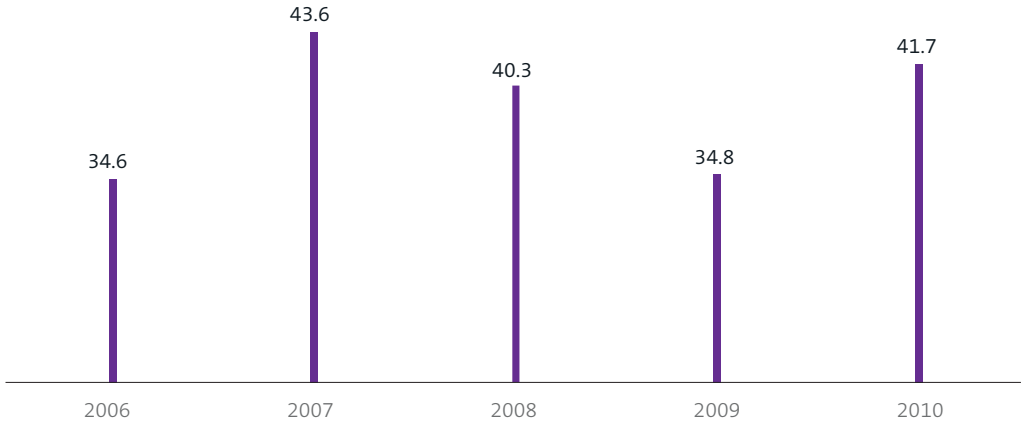
Balances registered by the AIAF fixed income market through December dropped by 2.4% year-over-year, while balances rose by 13.6% in the public debt market. The balances of equities were also largely stable during the course of the year, declining by 11% from the year before at market prices. Nominal amounts at year-end 2010 reached a combined volume of €1.56 billion in the Equity and Fixed Income markets (both public and private). This represents a 3.4% increase over the figure for year-end 2009.

Unit earnings

Revenues at the Settlement Unit in totalled €75.27 million, for a 10.8% increase yoy. Operating costs dropped 2..9% to €13.93 million, while EBITDA climbed 14.4% to €61.34 million.

If the failed trade handling service is stripped out, revenue associated with registration climbed 0.2% in the year, while settlement revenue rose by 23.4%.

Trades settled by Iberclear in 2010
Million



Participants in ECSDA international meeting celebrated in Madrid.

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Business Areas

Other activities

The Clearing and Settlement area performs a number of activities directly related to the systems and functions historically used and developed by IBERCLEAR. Some are performed locally, while others are international in scope. The majority consist of projects scheduled for implementation over several stages. They include the following:

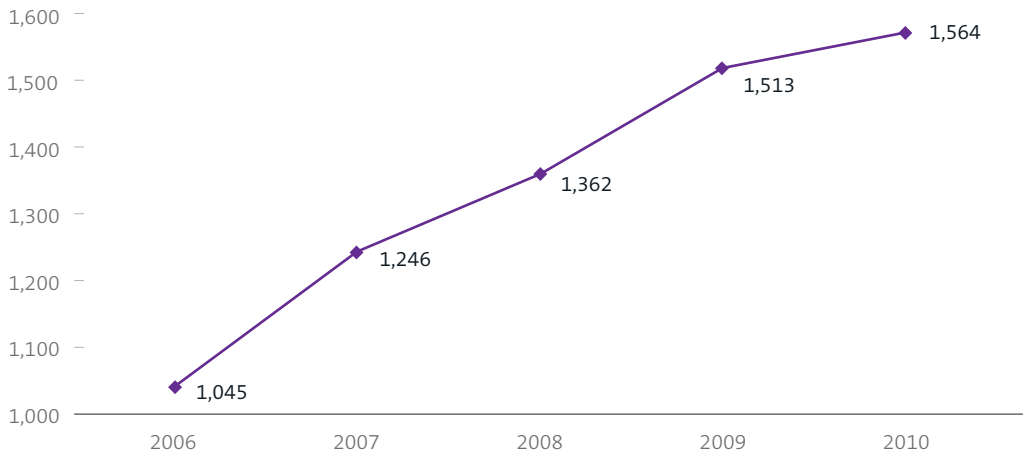
• Registry for OTC Financial Instruments Traded

BME in 2009 announced the creation of a Registry (Trade Repository) for a wide range of Over the Counter (OTC) financial instruments, in line with the EC press released issued on 20 October 2009 *(http:ec.europa.eu/news/economy/091022)*. This registry will offer greater control, security and transparency in trading in these products. The Spanish bourse made great progress in implementing and launching the first European trade repository, REGIS-TR, within the framework of ensuring transparency in OTC operations, mainly through the use of trade registers by all counterparties, including non-financial counterparties.

A Circular was published on 29 September enacting rules for procedures for notification, settlement and registration of transactions in securities listed in the stock markets and OTC trades and reported to IBERCLEAR for settlement and registration in accordance with the provisions of Chapter V of the General Regulations. A Circular was also approved to regulate requirements and procedures for membership to enable members to access the aforementioned services.

Subsequently, on 11 November, the implementing regulation was published and the inception date of 18 January 2011 was set. Registration and clearing have since been up and running for OTC transactions and transactions arranged in the regulated market or multilateral trading system and notified by the participant acting on behalf of a Central Counterparty Clearing house.

Assets under custody
Nominal amounts registered. Millon euros



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Business Areas

Following the formal creation of REGIS-TR and the start of operations on 9 December, work commenced on the functional analysis of the following phase, in which currency derivatives will be developed, with a view to implementation in the second quarter of the year. REGIS-TR is a joint project between BME and Clearstream Banking.

REGIS-TR, a trade repository to bring transparency to the OTC derivatives market.

• RENADE

Spain's National Registry for Greenhouse Gas Emission Allowances (RENADE) was affected in 2010 by amendments to EU laws and regulations, as a result of approval of two European Parliament and European Council directives which updated the European emissions rights trading regime and expanded its scope to encompass new industries and additional greenhouse gases. Targets call for global emissions of greenhouse gases to be reduced by at least 20% from 1990 levels by 2020.

RENADE remained active in a range of projects, highlights of which included preliminary efforts to adapt to the future Single Registry, set to take effect on 1 January 2012. This Consolidated Registry will record emissions allowances held by all countries in the European Union. Work began in 2010 to design the new scheme, in conjunction with other member states and the European Commission, to develop a structure and data model for the registry.

• Link Up Markets

Egypt's central securities depositary (CSD), MCDR, and its South African counterpart, Strate, in November successfully connected to Link Up Markets, a vehicle currently composed of 10 CSDs which aims to enhance efficiency and reduce settlement-related costs on cross-border securities trades worldwide. The MCDR and Strate connection culminates the launch plans for Link Up Markets and paves the way for total interoperability among its members.

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REGIS-TR: Spain's response to the transparency requirements of OTC derivatives

In 2010 the Spanish stock market took significant steps towards the implementation and start up of the first European trade repository: REGIS-TR. This is an important step towards involving the regulated markets in the instrumentation of tools that, by helping to improve the transparency of the financial markets, will make them more efficient and risk-free.

OTC derivatives have traditionally been used as a hedging tool, although they have also been used as active trading assets. The market has grown at an annual rate 30% - 40% in the last few years. The most widely used instruments are *Interest Rate Swaps (IRS) and Credit Default Swaps (CDS)*. The latter, as is well known, were one of the triggers of the financial crisis, evidencing the lack of control and transparency inherent to excessive exposure to the risks of OTC derivatives operations.

The financial crisis that broke out in 2007 and culminated with the collapse of Lehman Brothers in September 2008 brought into evidence the deficiencies of the OTC markets compared to the regulated markets. The opaqueness of OTC markets acted against them when doubts about the solvency of certain financial intermediaries arose, causing a severe shortage of liquidity and the collapse of these markets.

What lessons were learned? Firstly, comparing the regulated and OTC markets it can be observed that the regulated markets are characterised by the transparency of their operations and risks assumed, they have reliable liquidity-providing mechanisms, show strength at critical times and efficiency in price setting while the OTC markets are highly inefficient due, among other reasons, to the lack of control, uncertainty, and lastly, the non-transparent nature of the operations that are an intrinsic part of their functions.

The various proposals to confer greater transparency to the OTC derivatives markets form part of the raft of measures that regulators and supervisory bodies across the globe expect to implement in order to ensure that the situations that arose during this financial crisis do not re-emerge. Therefore, regulators have focused on two lines of action:

- The first, aimed at reducing credit risk, involves chanelling trading volumes into standardised products, that, due to their nature, have lower risk and greater transparency, as they can be contracted on organised markets or trading platforms and/or settled through Central Counterparty Clearing houses (CCPs). It has been suggested that trades that cannot be standardised and admitted by a CCP should be "cleared" either mandatorily or via incentives, through this channel.
- The second line of action is aimed at ensuring transparency in OTC operations, mainly through the use of trade registers by all counterparties, including non-financial counterparties. Discussions between regulators and supervisors on both sides of the Atlantic have focused on the role of trade repositories.

Trade repositories appear to be the answer to the needs of the regulator and the financial markets, covering all types of OTC derivatives efficiently and economically.

On 15 September the EU published a draft of the European Market Infrastructure Regulations (EMIR) outlining the basic points to take into account for all participants in the OTC derivatives markets, whether a financial entity or not. These include electronic confirmation for non-standard trades which cannot be cleared via a central counterparty. This electronic confirmation will be fully auditable at all times. This legislation is expected to come into force in the second half of 2012.

Given this scenario, in 2009 BME announced the creation of Europe's first trade repository. In July 2010, Clearstream joined the project known as REGIS-TR. This system will collect and manage specific information on all OTC derivatives trades reported by users and provide participants and regulators a global overview of their positions in OTC derivatives, which is currently unavailable. Clearstream's adherence to BME's initiative is a reflection of the international reach of this project. BME considers that the participation of Clearstream will strengthen and enhance the register's potential.

Customers are not only looking for a European solution that will comply with future transparency obligations in the OTC derivatives market but also for services that will help them in administrative and management processes relating to trades in these instruments. BME and Clearstream are in an ideal position to enable customers and regulators alike to meet their objectives easily and efficiently. The pooled experience of the two companies and their market coverage will allow them to efficiently sell this product and extend their offer to cover other types of OTC derivatives.

Specifically, for all market participants this would be an early solution for a future obligation, allowing them to ready themselves for this new requirement. Additionally, this joint action ensures that the service retains sufficient flexibility to adopt to future legislative changes, seeking to find the most efficient economic solution at all times.

Market Data and Information

This area reinforced its position as the third-largest contributor to revenues and EBITDA, representing 9.9% and 10.8% of the total, respectively.

The mixed performance of the different client segments and information levels helped cushion the impact on revenue of a drop in subscribers; the area sustained a 5.7% decline in revenue to €31.20 million. EBITDA after operating expenses (€6.45 million) was 5.4% lower than in 2009, at €24.74 million.

This area largely comprises two companies engaged in distinct activities: BME Market Data and Infobolsa, jointly owned with Deutsche Borse, Germany's top stock exchange operator.

BME Market Data

BME Market specialises in generating and selling information generated by BME's Regulated Markets and Multilateral Trading Facilities (MTFs) and in developing value-added services aimed at the securities industry.

BME Market Data's range of real-time content was expanded in 2010 thanks to the addition of new instruments in the ETF, warrants, certificates, SEND and MAB markets. Similarly, its catalogue of indices calculated and distributed in real time was bolstered in April 2010 with five new indices within the IBEX® family.

Highlights of the new BME Clima project include the creation of a family of meteorological indices which provide historic and up-to-date information on variables such as temperature, precipitation, sunshine and wind speed for many locations in Spain. These indices, supplied by BME Market Data, are geared towards managing the risk associated with financial losses from adverse weather conditions.

In the area of technology infrastructure, in 2010 the company successfully migrated direct recipients of information to the new architecture implemented by BME Market Data for the distribution of real-time information (BME Data Feed). This new architecture makes BME Market Data's real-time information distribution business more robust, reliable and flexible in content management, and represents a state-of-the-art model for technology consolidation which immediately achieved significant infrastructure cost reduction for direct recipients of information.

Moreover, BME Market Data offers a Transaction Reporting Service which allows institutions to send the CNMV reports of trades executed on all securities included in Article 2 of the Securities Market Law that are conducted outside of BME's Regulated Markets and Multilateral Trading Facilities.

Finally, a new family of historical and end-of-day data products were developed last year and are set for release sometime in 2011. These products will give BME Market Data customers an opportunity to obtain, at their explicit request or by subscription, data on prices, volumes, best positions, trades, significant events and descriptions of securities for all instruments listed on BME's range of markets. These products were developed for BME Market Data in response to repeated requests from customers seeking to improve their processes for research, automated trading, valuation and market order execution control, as customers demand the highest quality and level of standardisation in market information.

Infobolsa

As in 2009, Infobolsa in 2010 focused its efforts on maintaining its leadership position in Spain and strengthening its presence in Mexico by adding new services in this market.

It is worth noting that in Spain and Portugal the company maintained its number of financial terminals, while in Mexico it exceeded the 1,000-mark in professional terminals for the first time.

ASP services likewise remained highly stable in 2010, with a small rebound in data flow services, while the figure for Internet-based financial solutions (ASP Services) held steady. Revenue from Spain and Portugal improved from a year earlier, while the number of customers for these services in Germany remained stable.

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Business Areas

Finally, the company's website maintained its usual number of visits (more than 14 million), though it attracted more page views (88 million) and monthly users (314,852 users). A highlight for this department was Advertising, which improved its 2009 revenue, albeit with a drop in subscription services in this retail segment.

The company's top priority in 2011 is to maintain current performance across its businesses. To this end, Infobolsa will provide its services over new, increasingly in-demand platforms as they become available.

The launch of other company services in Mexico, where Infobolsa already enjoys a broad customer base, is another of the company's strategic priorities for 2011.

What's more, the company will build on its 2.0 strategy, which is extremely important for generating additional revenue in the retail segment, cementing and re-launching the Infobolsa brand in Spain and laying a foundation for the launch of new products and services in Spain and other countries.

The information distribution market is undergoing a transformation, driven by a number of factors, primarily the rise of a new private banking trend which, along with regulatory compliance obligations, requires new tools, not only for processing information but also for control and management. These require information redistributors to perform consulting and research duties as a prelude to developing solutions which are becoming less general and more customised.

In this regard, the company's July agreement to buy 62% of Open Finance, S.L., a leader in front-office solutions for financial advisory and portfolio management, in 2011 will allow Infobolsa to further diversify by broadening its range of available services within the financial advisory business. Both companies plan to extend the international reach of their solutions, particularly in Latin America.

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Business Areas

IT&Consulting

The activities encompassed in this BME business area represent its most recent developments. This Business Unit, which raises revenue from various products and managed services, is thus the company's youngest division. Nevertheless, it is performing well, contributing 1.8% to Group profit and 4.6% of revenue in 2010.

Its work revolves around three differentiated fields of activity managed under three brand names: Visual Trader, BME Innova and BME Consulting.

BME Consulting

BME Consulting exports technological systems and platforms, provides strategic consulting services for financial markets and offers specialised training. All in the international arena.

BME Consulting's technology business in 2010 focused on trading platforms, primarily the SIBE. Five Latin American markets now use the SIBE trading platform. BME provides online support, software maintenance and upgrades to markets in Venezuela, El Salvador, Uruguay, Ecuador and the Dominican Republic.

The following projects were successfully completed in 2010 in the strategic consulting business:

- In Croatia, a project for coaching trainers at the Zagreb Stock Exchange in areas related to financial markets (equities, debt, derivatives, regulatory compliance, etc.), and advising this Stock Exchange on how to set up a training institution. The project was carried out in conjunction with Instituto BME and Escuela de Finanzas.

- In Mexico, research on international best practices and development of an implementation plan for the creation of a self-regulated market for small- and medium-sized businesses.

- In Ukraine, customised guidance on financial markets for the purpose of strengthening the Ukrainian financial system. As part of this project, in October 2010 a study tour of Spain was organised for 13 representatives of the four institutions benefiting from this project. These individuals travelled to Spain to receive on-site training at Spanish peer institutions. They visited the following institutions: BME, FOGAIN, the CNMV, the Ministry of Economy and Finance, the General Directorate for Financial Legislation and Policy, the Bank of Spain and the General Directorate for Insurance and Pension Funds.

The consulting division continued to submit technical proposals for several tenders in Latin America, Europe, Africa and Asia, which are currently under assessment.

Finally, BME Consulting also works to develop training venues. It held a new edition of the Regulatory Compliance Course in conjunction with the ICMA Centre and Instituto BME. It is currently at work on designing custom-tailored training plans and courses and on researching prospects for offering advisory assistance to several institutions on how to launch training institutes in Latin American countries.

Visual Trader

Visual Trader's main goals in 2010 focused on two areas: ongoing improvement in the applications and services the company sells and expansion and diversification of its business.

In terms of improvement, after completing systems migration to the new Linux platform, the main 2010 goal shifted to continuing the development required to complete and enhance the applications rolled out by Visual Trader. In this area, the trading terminal maX was enhanced with added features:

- The new Ticker Plant: to address low-latency needs while receiving market information, enhancements were developed to speed up per-second message processing and improve capacity. Furthermore, Visual Trader rolled out a new, high-performance distribution protocol, VT Binary, which can process more than 1,000,000 messages per second.

- Recently unveiled graphic features including new chart model TradeChart and the

MarketsInsight service, which consists of charts and statistical information in real time to assist trading and will be accessible over the Internet.

• Significant upgrades to algorithmic trading: development was completed on the PATS (Personal Algorithmic Trading Spreadsheet) system, a market simulator and new market statistics information service and application of forecasting models. The PATS consists of an Excel-based environment with the features and accesses necessary to allow users to develop their own algorithmic trading models.

As for trade-routing systems, especially into the Spanish market, improvements were geared towards reducing latency and enhancing performance. Fine-tuning was completed on the SIBE Submillisecond Sponsored Access (SSSA) system, designed for non-members of the Spanish market, offering the fastest current access to SIBE with sub-millisecond latencies.

The company signed agreements with three new brokerages for the execution of orders in international markets, while five new Spanish members joined in order to trade using Visual Trader systems.

As part of efforts to expand and diversify, 2010 was a year of expansion for Proximity services managed by Visual Trader, which provide top-level international financial institutions with the fastest access to the Spanish market. Diversification projects in 2010 included the opening of two hubs in London, linked by two independent, low-latency lines, with a dual purpose: on the one hand, to facilitate and improve access quality for all institutions operating from London in the Spanish market, and, on the other hand, to improve latency and costs associated with Spanish institutions' access to international securities markets. This project became available in the fourth quarter of 2010.

BME INNOVA

BME INNOVA was created in 2007 as BME's innovation subsidiary, concentrating on the innovation and development of new products and services that generate value for clients; i.e. BME's innovation driver. Its mission is to turn BME's assets and expertise into products and services within the reach of any company, with constantly updated technology, strict information processing protocols, first-rate expertise in IT security and confidentiality, supplemented by a deep understanding of the tasks and workflows involved in the financial industry.

These assets were the foundation of BME INNOVA's work in 2010 and may be divided into three areas: Business Continuity, Financial Communication and Management Software for Financial Institutions.

First, BME INNOVA decided to leverage its business continuity know-how with the creation of the BME ALTERNATIV range, custom-tailored to meet the needs of financial institutions and large corporations. More than half of BME's market members have contracted for these services. BME INNOVA subsequently extended its business continuity services to address the needs of small- and medium-sized businesses in any industry, using its patented tech platform.

To address companies' needs and lower their management costs, BME ALTERNATIV's business continuity services division in 2010 evolved to offer production services. Its range of services includes housing, hosting and outsourcing.

Meanwhile, through the Spanish Business Continuity Consortium or CECON, BME INNOVA actively promoted the Instituto de Continuidad de Negocio, known as CONTINUAM, becoming a founding member.

Under the rubric of financial communication services, BME capitalised on its experience in financial courier services via the SWIFT network and in TARGET 2 to make BME INNOVA a SWIFT service bureau and develop BME HIGHWAY. These services, initially offered under an outsourcing regime, currently generate savings of around 37% for customers.

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Business Areas

Finally, in the area of management software for financial institutions, BME INNOVA launched its BME CONFIDENCENET range of services, which, among other features, facilitates regulatory and reporting compliance at companies subject to CNMV oversight. The solution designed for the Spanish market is a private cloud services model installed in an environment of the utmost security, confidentiality and privacy for each participant via virtualisation technologies. This tech innovation model applied to market oversight is a success in the Spanish market.

The debut service, launched in January 2009 to facilitate regulatory compliance with reporting obligations for financial statements (SIR) and initially designed for brokerages and securities firms, was rapidly extended to collective investment institution management companies, or SGIICs, capital risk firms (private equity funds and venture capital management companies (ECRs and SGECRs), financial funds, property funds, hedge funds, EU funds, EAFIs and lending institutions. This service now includes more than 150 participating entities.

Based on the same approach to innovation, the company in January 2010 launched a Reporting Service for Market Abuse and Suspect Transactions, or SICAM. More than 40 companies of all sorts and sizes now use this service, from savings banks to large lenders to brokerages.

Other BME CONFIDENCENET products include RIC, a service for assisted management of internal codes of conduct, and the DESGLOSES service, which helps brokerages and broker-dealers to resolve issues surrounding enrichment of orders introduced across different markets for subsequent publication and settlement.

Earnings from these activities

Combined revenues from IT & Consulting activities totalled €14.4 million in 2010 (down 14.87% from 2009). Operating costs fell by 0.3% to €10.27 million. Finally, EBITDA dropped by 37.1% to €4.17 million. To varying degrees, this division's businesses reflected both the cost of start-up investments in projects that will take at least one year to reach maturity and the difficult economic circumstances afflicting many Spanish companies.