Tradeweb 4Q19 Earnings Conference Call Script

This transcript should be read in conjunction with the related earnings presentation, which includes important additional detail, and is provided for the convenience of investors and analysts only. For a full recording please see the 4Q19 Earnings Call webcast.

OPERATOR

Good morning and welcome to Tradeweb's fourth quarter 2019 earnings conference call. As a reminder, today's call is being recorded and will be available by playback.

To begin, I'll turn the call over to Head of U.S. Corporate Development and Investor Relations, Ashley Serrao. Please go ahead.

PART I: INTRODUCTION AND DISCLAIMER

ASHLEY SERRAO (Slide 2-3)

Thank you and good morning.

Joining me today for the call are our CEO Lee Olesky, who will review the highlights for the quarter and provide a business update, our President Billy Hult who will dive a little deeper into some growth initiatives and Bob Warshaw, our CFO who will review our financial results.

Our fourth quarter earnings release, accompanying presentation and January volumes report are available on the Investor Relations portion of our website.

I'd like to remind you that certain statements in this presentation and during the Q&A may relate to future events and expectations, and as such, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from these forward-looking statements. Information concerning factors that could cause actual results to differ from forward-looking statements is contained in our earnings release and periodic reports filed with the SEC.

In addition, on today's call we will reference certain non-GAAP measures. More information regarding these non-GAAP measures, including reconciliations to GAAP measures are included in our earnings release and earnings presentation posted on our website.

Lastly, we provide certain market and industry data which is based on management's estimates and various industry sources. For more information, see our earnings presentation posted on our website.

To recap, this morning we reported GAAP earnings per diluted share of $0.25. Excluding certain non-cash stock-based compensation expense, acquisition and Refinitiv related D&A and certain FX items, and assuming an effective tax rate of 26.4%, we reported Adjusted Net Income per diluted share of $0.26. Please see the earnings release and the Form 10-K to be filed with the SEC for additional information regarding the presentation of our historical results.

Now, let me turn the call over to Lee.

PART II: OVERVIEW & FINANCIAL RESULTS

LEE OLESKY (Slide 4-7)

Thanks Ashley. Good morning everyone and thank you all for joining our fourth quarter earnings call.

Since our inception, we have harnessed the creativity of our employees and power of our technology to solve problems for our growing global network of clients. We also continue to respond to secular trends. These include the increasing sophistication of technology, globalization of debt, focus on reducing cost, proliferation of data-driven decision making and the growth of ETFs driving changes across other trading products. These are the defining trends that we believe will fuel the digitization of markets and improvement in the quality of trade execution for our clients.

As you can see on slide 4, in 2019, our continued focus on client needs led to another year of strong execution at Tradeweb. Record volumes translated into 13% and 15% revenue growth on a reported and constant currency basis, respectively. As a result, we recorded our 20th consecutive year of record revenues. The scale generated by our strong top-line results drove approximately 500 basis points of EBITDA margin expansion and 22% earnings growth. And as our growth initiatives continued to scale, we maintained our tradition of consistent and focused organic investment.

In institutional credit trading, after leveraging the liquidity of our treasury platform to support net spotting, we continued to innovate by adding electronic portfolio trading-- a game-changing protocol that has seen strong uptake by our clients. We further enhanced AiPrice in credit, that today prices over 19,000 bonds and functions as the reference price for our electronic session and portfolio trades. Beyond credit, we leveraged our multi-asset class footprint to electronify asset swaps and improve our block trading solution for U.S. options. We also expanded our U.S. Treasury streaming offering to cater to institutional clients—for the first time institutions are now able to consume customized liquidity, complementing their RFQ workflows on Tradeweb. Additionally, we executed several partnerships and integrations, augmenting our offering for institutional municipal bonds with Investortools, interest rate swaps with OpenGamma and Cassini and market data with ICE, to just name a few.

2019 also marked another milestone for Tradeweb as we began a new chapter in our life as a publicly-listed company. Our IPO has elevated our brand globally and made us a more attractive destination for top-tier talent. During 2019, we added senior talent across cyber security, data, technology, infrastructure and product management.

As we look ahead, we expect 2020 to be no different. We will continue to operate with a growth mindset and invest to amplify our network, enhance our global footprint and pioneer electronic solutions across our asset classes. Our operating philosophy remains the same—we will do this by leading advances in financial technology and continuing to strategically work closely with both existing and new clients.

Turning to slide 5, we reported the strongest fourth quarter in our history and set multiple new volume records across U.S. high grade and high yield credit and equity derivatives.

Specifically, gross revenues of $197 million during 4Q19 were up 10.5% yr/yr on a reported basis, and nearly 12% on a constant currency basis, despite a significantly lower overall industry volume and volatility backdrop when compared to the same period in 2018. Our financial performance was once again characterized by strong growth, both domestically and internationally. We continue to be pleased with our international progress and see a lot of potential to continue to scale our footprint across European, Asian and emerging markets over time. Our double-digit revenue growth and the resulting scale translated into improved profitability as our fourth quarter Adjusted EBITDA margin increased to 46.9%.

Turning to slide 6, you can see the diversity of our revenue growth as our biggest asset classes, rates and credit, continue to grow strongly. Specifically, they both registered their eighth consecutive quarter of double-digit revenue growth. Our equities revenues declined yr/yr given challenging comparisons for the U.S. ETF market relative to 4Q18 that was marked by substantially elevated volatility and tax-management trades given the market sell-off in December of 2018. Our data business grew 16% on a reported and constant currency basis.

Moving on to slide 7—let me provide a brief update on our four main focus areas—global interest rate swaps, U.S. Treasuries, U.S. credit and global ETFs.

Starting with our largest rates product by revenue, interest rate swaps— our total volumes were up over 30% yr/yr during 4Q with swaps greater than one year in duration growing by over 11%. We continue to be very focused on driving electronification higher in this market by partnering with our clients to broaden our product set, enhance our functionality and improve workflows.

Moving on to U.S. Treasuries—while our volumes were down 3% yr/yr given challenging market conditions during the fourth quarter, I am pleased that our organic growth initiatives have allowed us to take share here using a variety of trading protocols in both the institutional and wholesale sectors. We estimate that our share as of year-end was 12.5% of the U.S. Treasury market. We hit another record on our wholesale streaming platform as we continue to leverage our proprietary technology to actively onboard a healthy pipeline of dealers—traction has continued into 2020 with streams reaching another record in January.

The U.S. Treasury closing price initiative in partnership with ICE has generated a lot of interest in the industry given the demand for trusted reference price data. We have already enhanced the methodology and are currently engaged with a variety of industry bodies and participants to drive adoption.

We made rapid strides in U.S. corporate credit during the fourth quarter as we continue to lead the current wave of innovation. We estimate that our overall share in high grade and high yield increased to a record 15.8% and 4.3%, respectively, with electronic share also hitting new records. Our institutional client count increased by 18% year over year. We see significant runway to grow as our network and liquidity continue to become stronger. The momentum has continued into 2020, as we reported new volume records for both overall high grade and high yield trading in January, as our strategy of focusing on the entire U.S. credit market, including making strong inroads into the institutional sector, continues to pay off.

Finally, within institutional ETFs—volumes were up 5% as organic growth efforts in Europe more than offset subdued market volatility. Going ahead, we remain well-positioned to benefit from the continued growth of ETFs globally. Today, we see a broad range of clients interacting over our ETF platform from pension funds to wealth managers to hedge funds as our solutions continue to facilitate the transfer of block risk more quickly and efficiently than alternative venues. Building on our success in ETFs, over the past few quarters we have developed an RFQ solution for U.S. options—it's still early days for that, the business is off to a promising start and nicely complements our flagship ETF RFQ offering.

With that I will turn it to Billy to give you some more color on trading automation, global swaps and portfolio trading.

BILLY HULT (Slide 8-9)

Thanks Lee. Our markets continue to evolve gradually led by the twin driving forces of workflow simplification and advances in risk management. But once in a while a single innovation like portfolio trading really revolutionizes the way trading is done. I will talk about that in a bit but let me start with an update on a multi-year trend that is unfolding around OTC trading automation and how we are using AiEX to be the market leader on slide 8.

AiEX

The search for liquidity continues to become more quantitative. We are helping our clients navigate the growing complexity involved in staging orders to improve execution outcomes with rules-based trading. For years, dealers have continued to invest in auto-quoting capabilities. AiEX allows the buy-side to interact with dealers more efficiently by sending inquiries in an automated fashion. This is a win-win solution for both sides. We are leading this automation of trading in fixed income, ETFs and now across derivatives, leveraging our wide network and OMS integrations.

Today, approximately 25% of our institutional trades are driven by AiEX with plenty of room to grow— our top 10 AiEX users have automated over 50% of the trades they send to Tradeweb on average, doubling their usage over the last four years.

After adding a record number of new clients in 2019, the pipeline remains strong. We are also seeing trade sizes gradually increasing, especially as AiEX continues to penetrate swaps. Trading behavior is changing as we speak and we are still in the early days of adoption. There is plenty of room for automation to grow even within our top 100 and most sophisticated clients.

Global Swaps

Another key growth area for us is global interest rate swaps. 2019 was another record year. The investments we made to respond to market structure changes like the advent of central clearing and demand for compression tools are paying off. Our ability to also offer trading in correlated and adjacent asset classes like mortgages and government bonds has also helped attract more swaps traders to our platform. It has also allowed us to connect markets with innovations like electronic multi-asset package trading. When combined with Tradeweb's expertise in navigating regulatory change, we believe we have become the leading venue for clients to trade interest rate swaps.

Our market share continues to increase and we believe our offering is resonating across currencies. It's important to note that volume growth is not just confined to Europe—a region that is undergoing rapid change post MiFID II— we are seeing broader based regional growth.

On the regulatory front, we are partnering with market participants to help them transition swaps away from LIBOR indices. Specifically, we are providing transparency into risk-free rates and portfolio solutions to switch reference rates.

Improving client workflows has been fundamental to everything we do at Tradeweb and swaps is no different. We are now expanding our request for market solution or RFM to include more swap types. RFM is a great example of a solution where we have partnered with our clients to move large risk efficiently and electronically while mirroring the protocols used in voice execution. We are very focused on ensuring that clients have access to the broadest scope of protocols to execute their interest rate swaps.

U.S. Credit

Turning to credit on slide 9, 2019 further validated our differentiated approach to the credit market. We are laser focused on the big picture which is helping clients leverage our search engine in an illiquid market to find the other side of a trade—this focus, our heritage of pioneering electronic solutions across asset classes and the creative talent that Lee referred to earlier has helped us lead the current wave of innovation in corporate credit.

We are defining the future of electronic credit trading by using our proprietary technology to integrate liquidity across the traditional retail, institutional and wholesale sectors. Our multi-sector presence allows us to focus on bringing electronic workflows to 100% of the U.S. credit market today as measured by TRACE. Electronic and digital execution workflow options in credit have never been better for customers and you can find all of them at Tradeweb.

During the fourth quarter, our market share increased materially as our network continued to season and client engagement improved. As Lee mentioned, the momentum has continued into January and we believe we have significant runway to add more clients and grow our market share across both high grade and high yield credit.

When we step back, we are pleased to report that our differentiated strategy and focused investment is firing on all cylinders— our growth was broad-based across both traditional protocols such as A2A and RFQ and also across the next generation of innovations that we are leading such as net spotting, session trading, connecting retail liquidity into institutional RFQs and portfolio trading.

We are very excited about the future of portfolio trading which we see growing in tandem with the growth of fixed income ETFs and the increasing precision of real-time reference pricing sourced from tools like Tradeweb's proprietary AiPrice. This is a lightbulb moment with our most sophisticated and largest clients. It is a global trend and we believe more clients will follow. We estimate portfolio trading has grown rapidly over the last 18 months to now account for 3-4% of TRACE.

This is another win-win solution that addresses the inefficiencies in list trading. Clients are able to now trade large and complex baskets containing a mix of bonds across the liquidity spectrum at an attractive price with speed and certainty. Dealers are able to increase balance sheet velocity and reduce holding periods. Many dealers have created or are in the process of creating dedicated portfolio trading desks to capitalize on this trend. They are also investing heavily in improving their tools to price and manage this risk. Looking ahead, we expect client demand to continue to increase and dealers to continue to play a central role in driving the broad-based adoption of portfolio trading.

With that, let me turn it over to Bob to discuss our financials in more detail.

BOB WARSHAW (Slide 10-14)

Thanks Billy and good morning. As Lee indicated, our continued year over year growth in the fourth quarter, our full year 2019 growth in volumes, revenue, earnings and improved margin, and our volumes in January 2020, lead us to have confidence that by providing sustained value for our clients, we also are creating sustained value for our shareholders.

As I go through the numbers, all comparisons will be to the prior year period, unless otherwise noted.

Let me begin with an overview of our volumes on Slide 10.

- We reported quarterly ADV of $685 billion, up 16%—as you can see the growth was broad-based. We believe the diversity of our business is one of our strengths.

Slide 11 provides a summary of our quarterly earnings performance.

- The strong volume growth I just described translated into gross revenues increasing by nearly 11% and by 12% on a constant currency basis. We derived ~35% of our revenues from international customers and recall ~30% of our revenue base is denominated in currencies other than dollars, predominantly in Euros.
- Our variable revenues increased by 14% and our total trading revenue increased by 10%.

- Fixed revenues related to our 4 major asset classes continued to grow as expected—we continue to expect a low single digit growth rate going forward.
- Other information services increased by 22% due to growth in our APA reporting business.
- Adjusted EBITDA margin came in at 46.9% and expanded nicely relative to 4Q18 as we continued to benefit from scale and the lack of IPO related costs. Full year Adjusted EBITDA margin increased to 45.5% from 40.8% in 2018.
- All in, we reported Adjusted Net Income per diluted share of $0.26.

Slide 12 lays out the trends in fees per million. We have not made any changes to our fee schedules—the trends I am about to describe are driven by mix of the various products within our four asset classes.

- In sum, our blended fee per million declined 3% yr/yr; but, excluding excluding lower FPM short tenor swaps, our blended fee per million was up 2% yr/yr.
- Let's spend a minute reviewing the underlying trends by asset class.
- Starting with rates
  - Average fees per million for rates decreased slightly due to mix shift towards short tenor swaps.
  - Excluding short tenor swaps, FPM was up yr/yr primarily due to growth in non-TBA mortgage activity which carries a higher FPM.
- Continuing to credit
  - Average fees per million for credit increased 9%.
  - This was primarily driven by mix shift away from derivatives products due to higher growth in cash products as our investments to grow electronic credit pay off.
- Continuing with equities
  - Average fees per million decreased 20%.
  - This was primarily driven by growth in U.S. equity options, which carry a lower FPM than other equities products. We expect U.S. equity options to continue to grow as we onboard clients and as liquidity builds.
- Finally within money markets
  - Fee per million decreased 9%.
  - This was primarily driven by growth in repo which carries a lower FPM than other money market products.

Slide 13 details our expenses

- At a high level, we continue to invest for growth—there has been no change to our philosophy here.
- While our 4Q operating expenses declined year-over-year, our full-year 2019 adjusted expenses grew more than 4% and almost 5% on a constant currency basis, in line with our expectations.
- As a reminder, Adjusted Expenses excludes non-cash stock-based compensation expense related to options, Acquisition and Refinitiv related D&A and certain FX related gains and losses.
- Adjusted Expenses for the 4Q declined 6.5% (7% on a constant currency basis). Recall ~15% of our expense base is denominated in currencies other than dollars, predominantly in Sterling.
- 4Q19 operating expenses were lower when compared to 4Q 2018, due to the timing of performance-related compensation accruals in 2018.
- Adjusted non-comp expense declined 3.5% (or 4.2% on a constant currency basis).
- Specifically, general and administrative fees declined as increased public company insurance expenses were more than offset primarily by one-time items such as a decrease in our bad debt reserve. We expect G&A to trend around $10-$11 million a quarter excluding the impact of FX going forward in 2020.
- Professional fees declined primarily due to reduced consulting and legal fees, in part driven by

elevated costs in 4Q18 tied to the IPO.
- Occupancy increased due to higher costs tied to our Amsterdam offices that we opened in response to Brexit.

Slide 14 details capital management and our guidance

- First on our cash position and dividend policy
  - We ended 4Q holding $461 million in unrestricted cash and cash equivalents and free cash flow for the year reached $267 million.
  - Capex for the year was $45 million, an increase of 6% year over year, in line with our expectations.
  - With this quarter's earnings, the Board declared a quarterly dividend of $0.08 per Class A and Class B share.
- Turning to Guidance for 2020
  - We will continue to invest in 2020, and are expecting Adjusted Expenses to range from $495M - $510M.
  - The midpoint of this range would represent an approximate 8% increase. We believe we can drive operating margin expansion at either end of this range.
  - As Lee and Billy mentioned, harnessing data to drive execution is an important part of our story. As such, our guidance includes $5 million of investments primarily tied to our data strategy. We also continue to invest in cyber security and risk. Our guidance also includes ~$3 million of duplicative rent expense in advance of a potential office move in 2021. We are still finalizing the specifics of our move and will be working with landlords to minimize the duplicative expense that we may incur.
  - For forecasting purposes, we are now assuming a non-GAAP tax rate for 2020 of 22%, compared to 26.4% in 2019. The lower tax rate is driven by both changes in marginal tax rates across various jurisdictions as well as windfall benefits from the PRSUs we award as part of our share based compensation. We expect these changes to recur in subsequent years.
  - We expect Capex to be about $45 to $50 million.
  - Acquisition and Refinitiv Transaction related D&A, which we adjust out due to the increase associated with pushdown accounting, is expected to be $110 million.
- Finally, let me discuss our share count.
  - We have updated our quarterly share count sensitivity for 2020 to help you calibrate your models for fluctuations in our share price.

Now I'll turn it back to Lee for concluding remarks.

LEE OLESKY

Thanks Bob. 2019 was another record year marked by numerous milestones for the company and our products. We continued to expand our opportunity set across all of our businesses and we are very excited by the potential we see for Tradeweb. We are focused on capitalizing on the various growth opportunities ahead of us and continuing to strike the right balance between investing for the future and driving margin expansion to create long-term value for our shareholders.

The markets that we operate in are fundamentally changing as we speak. We believe the digitization of fixed income is accelerating and this technology fueled transition will continue to play out for years to come. As such, we believe that our multi-asset, multi-sector, multi-protocol and global presence gives Tradeweb the ideal vantage point to both participate in and lead the next generation of progress.

The momentum from 2019 has carried over into 2020 so far with January volumes increasing 29% with broad-based growth across our four asset classes and new volume records in mortgages, European government bonds, U.S. corporate credit and repo.

I would like to conclude my remarks by thanking our clients for their business and partnership in the quarter and I want to thank my colleagues for their efforts that contributed to our strongest fourth quarter in our history and a record year for Tradeweb.

With that, I will turn it back to Ashley for your questions.

ASHLEY SERRAO

Thanks Lee. As a reminder, please limit yourself to one question only. Feel free to hop back in the queue and ask additional questions at the end. Q&A will end at 9:30 Eastern time. Operator, you can now take our first question.

THANK YOU

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