Tradeweb 2Q20 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 of this earnings conference call please see the 2Q20 Earnings Call webcast.

OPERATOR

Good morning and welcome to Tradeweb's second quarter 2020 earnings conference call. As a reminder, today's call is being recorded and will be available for 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 second quarter earnings release, prepared remarks and accompanying presentation 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. Statements related to, among other things, our guidance, including full-year 2020 guidance, and the COVID-19 pandemic, the potential impacts of which are inherently uncertain, are forward-looking statements. 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. Information regarding these non-GAAP measures, including reconciliations to GAAP measures are in our posted earnings release and presentation.

Lastly, we provide certain market and industry data which is based on management's estimates and various industry sources. See our posted earnings presentation for more details.

To recap, this morning we reported GAAP earnings per diluted share of $0.16. 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 22.0%, we reported Adjusted Net Income per diluted share of $0.30. Please see the earnings release and the Form 10-Q 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 4-6)

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

The world remains an uncertain place and we remain appreciative of the all efforts that are being made to combat this virus and restore the economy. We also recognize the various efforts both by our employees and external organizations to promote equality. On the business front, the second quarter saw broader market stabilization that began at the tail end of March.

At Tradeweb we continue to operate remotely focusing on engaging with our clients and innovating to develop new solutions. The quality and frequency of collaboration with clients has increased, along with their willingness to look at the entire Tradeweb product suite proactively as this pandemic forced them to reassess their electronic strategies. We remain excited by the opportunity ahead of us and remain committed to driving revenue growth and margin expansion over the next few years as our investments scale globally. Today, we are investing in developing and scaling new protocols across rates and credit, expanding our geographic reach especially in the Asia-Pacific region with early signs of success in Australia and commercializing our data to just name a few. Our sales team remains highly engaged and our technology team has a busy pipeline as we look out over the rest of the year.

Turning to slide 4, we reported the strongest second quarter in our history and set multiple new volume records across our products despite a challenging macro environment. Specifically, gross revenues of $212 million during 2Q20 were up 11.4% yr/yr on a reported basis and by 11.8% on a constant currency basis. Our financial performance was once again characterized by strong growth. Our continued double-digit revenue growth and the resulting scale translated into improved profitability year over year as our second quarter Adjusted EBITDA margin expanded over 200 bps to 47.8%.

Turning to slide 5, you can see the diversity of our revenue growth. While rates and money markets saw growth but at a slower rate than previous quarters, the other growth engines of our business were on display as credit and equities both grew by double digits, 24% and 38.6% respectively. Within rates, cash rate revenues, mortgages and U.S. Treasuries benefited from Fed actions while our core swaps business continued to do well too.

Moving on to slide 6—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 interest rate swaps—in a tougher macro environment characterized by lower interest rate volatility where core IRS volumes dropped by 14% according to Clarus, our core swaps volume, higher fee per million longer duration swaps, grew by 5%. Our total volumes were down 10% yr/yr during 2Q as a 30% decline in lower fee per million shorter-duration swaps more than offset volume growth in higher fee per million longer duration swaps. We continue to focus on what we can control—deepening our client wallet share and scaling new products like EM swaps. The focus drove global IRS share for 2Q to nearly 10% growing substantially year over year. We believe we gained meaningful share versus our closest competitor Bloomberg in both the U.S. and Europe post March as our deep liquidity pools and recent investments continue to pay off. Longer-term, we remain excited by the opportunity here as the rate cycle improves and the market continues to electronify. Billy will give you an update on our strategy momentarily.

Moving on to Treasuries— our volumes were up 14% yr/yr. Our share recovered nicely from the lows seen in March when voice execution was more prevalent as exceptional volatility gripped the US Treasury markets. Amidst a backdrop of heavy issuance and Fed purchases, our organic growth initiatives have helped us to continue to take share using a variety of trading protocols in both the institutional and wholesale sectors. We estimate that our share during the second quarter increased yr/yr to a record 12.7% of the entire U.S. Treasury market. The institutional business had several record days during the second quarter driven by record levels of new Treasury bill issuance. We continue to sign new clients and push new functionality to both further differentiate our offering from the competition and electronify the market. Our recently launched institutional streaming effort which we brand STAQ continues to see more interest from clients as new dealers are onboarded as liquidity providers. AiEX resumed its critical role in our client's workflow and we further enhanced our functionality during the quarter giving clients the ability to automatically execute at pre-set times. On the product front, we also added the 20 year bond to our offering.

One of our formulas for success has been our ability to scale our technology across sectors. On that note, amidst a more challenging backdrop for the wholesale UST market, we continue to onboard new dealers to our streaming platform as an alternative to the traditional order books. Session trading also continued to recover. Dealers more actively managed their balance sheets as comfort around working from home grew and as Fed purchase activity tapered putting the onus on secondary markets to exchange risk.

Shifting to our credit business which continued its strong growth, generating nearly $50 million in revenues driven by strength in both the cash and derivatives franchises in credit, our U.S. market share rebounded from March driven primarily by the normalization of the RFQ institutional business, as a result of innovations like portfolio trading and net spotting continued to see increased adoption and the growth of our anonymous trading protocols. The wholesale session trading business also rebounded as it generated higher revenue in each successive month versus March as spreads tightened. Our session trading business continues to trend towards highs seen earlier this year. Looking ahead, we see a lot of opportunity in credit and continue to be very focused on connecting the various components of our offerings as we use technology to converge our institutional, retail and wholesale liquidity pools.

Finally, within equities, this quarter was highlighted by institutional ETFs—volumes were up 39% due to a combination of volatility and our targeted growth efforts to continue to add new clients globally. Our other initiatives to expand beyond our flagship ETF franchise are also bearing fruit with momentum continuing in equity options, Delta1 business and convertibles. Looking ahead, we believe we remain well-positioned to benefit from the continued growth of ETFs globally, our newer product additions and an expanding client footprint.

In sum, despite the macro challenges, we continue to operate with a growth mindset and we are focused on collaborating with our clients to capitalize on the various opportunities ahead of us. These opportunities are spread across our multi-asset class offering and this quarter showcased the diversity of our revenue growth as robust trends in credit and equities led the way with rates and our money market business continuing to grow as well. In addition to organic growth, we are spending a lot of time evaluating M&A opportunities as cash builds on our balance sheet.

With that I will turn it to Billy.

BILLY HULT (Slide 7-8)

Global Swaps

Thanks Lee. Turning to slide 7 for a closer look at swaps. The broader industry backdrop in 2Q for interest rate swaps was challenging given the decline in interest rate volatility. Industry volumes as measured by Clarus were down 30% during the quarter driven primarily by a nearly 40% yr/yr decline in lower fee per million products such as overnight index swaps (OIS) and forward rate agreements (FRAs).

The higher fee per million core IRS market fared relatively better—down 14% year over year. But as Lee indicated, while core market volume declined, our core swaps business grew and increased its share.

Amidst this tough operating environment, we continue to invest for the future and remain very engaged with our clients. As a result, our market share increased to 9.8% from 7.6% last year driven primarily by gains within core IRS where share rose to a record 16% as our growth efforts continue to pay off.

These growth efforts are powering the next generation of our swaps offering. We are adding currencies, expanding our product set, introducing new protocols, responding to changes necessitated by the replacement of LIBOR, strengthening benchmarks and electronifying more of the wholesale swaps flow.

Specifically:

- In 2Q we saw record EM swaps volumes as large asset managers that are fully integrated into Tradeweb for major currencies leverage the same infrastructure to trade EM currencies. Clients have now traded $289 billion over the last twelve months. The momentum is building and today we have more than 30 clients and 12 dealers, both numbers doubling since 2Q19. Looking ahead, we continue to add more currencies and actively onboard dealers to provide liquidity and satisfy the demand we are seeing from our clients in 2020.
- We also are continuing to grow our electronic solutions for historically voice traded products such as swaptions and multi asset packaged swaps. Client have now traded $65 billon in multi asset packaged swaps since our launch in August last year.
- Our efforts to build a competitive FRA offering continue and the early signs are encouraging. We traded nearly $15 billion daily during the second quarter.
- Protocol wise, we are growing RFM or Request for Market which helps clients protect their intent to buy or sell by requesting a two-sided market. We are also investing to add other swaps types to our platform.
- Clients also continue to use our list trading protocol extensively with a record number of swaps executed in Q2. Clients are utilizing list trading to trade bespoke risk, migrate positions from LIBOR to new risk free indices, and switch portfolios between CCPs in anticipation of Brexit.
- And finally, on the data front, we recently partnered with ICE on their swap rate, which will now feature Tradeweb institutional quotes to improve the resilience of the benchmark used to price swaptions and rate-linked structured products.

In sum, we are offering the tools and capabilities to further electronify the global swaps market.

U.S. Credit

Honing in on U.S. corporate credit on slide 8. We continue to invest to build a franchise that can handle both electronic and voice workflows by leveraging our unique and diverse liquidity pool shared across our wholesale, retail and institutional sectors. On the last earnings call, we spoke about our belief that the pullback in our market share in March was temporary. As the quarter unfolded, market share rebounded as expected trending higher in each successive month, approaching the levels seen at the beginning of the year. Our network continues to grow and we now have more than 700 clients on our platform.

In terms of drivers, the composition of our share has changed. The rebound in share has been led by our institutional franchise which saw record IG share in June as our innovations such as portfolio trading and net spotting continue to resonate strongly with our clients and as our network continues to grow. Specifically, portfolio trading crossed the $100 billion cumulative volume threshold since launch with more than $30 billion single and multi-dealer portfolio trades in the second quarter alone. Clients continue to increasingly put dealers in competition and the number of line items in portfolios on our platform also hit a new record.

Our advanced net spotting offering saw another record quarter with nearly $100 billion of activity as clients increasingly co-mingle electronic and voice trades to maximize savings and eliminate the inefficiencies of manual processes. Our block share continued to increase as our liquidity pool deepens.

We also continue to invest in creating the broadest anonymous trading offering in the market, which today includes our all-to-all offering, session trading and middle markets franchises. Trading volume here rose to nearly $40 billion driven by growth in our all-to-all volumes which have doubled over the last year to record levels as liquidity continues to build along with our network of responders.

As Lee mentioned, we are very focused on connecting our three pools of liquidity—to this end, our effort to incorporate retail liquidity into institutional RFQ trading continues to see increased adoption. Today we have billions in unmatched inquiry that interacts with our platform—we are very focused on leveraging our technology to optimize price discovery and maximize matches by connecting inquiries across sectors.

Turning to the rest of our credit business, we believe one of our strategic advantages is the diversity of our credit franchise which allows us to participate in the electronification of a variety of credit products. Our Credit Default Swap business, posted another strong quarter as we continued to gain more market share. Our efforts to grow our institutional muni business also continue to pay-off setting a new volume record.

In sum, we believe our credit business has a lot of room to run and we have an exciting roadmap to lead innovation across the credit markets. This includes investments in next generation technology that we have already launched like net spotting and portfolio trading and also the next wave of technology to drive the convergence in our three liquidity pools, enhance anonymous trading and optimize AiEX for credit.

Stepping back, innovation is a theme that continues across all our products and not just credit as we focus on growing share by helping markets digitize. We are investing in our electronic specified pools offering which has seen a surge in demand as traders work from home, given current highly manual and spreadsheet based workflows. We enhanced our agency bond platform giving clients the ability to now request prices from all dealers in a single inquiry improving price discovery. We continue to onboard new dealers and clients to our repo platform both domestically and in Europe where we expect upcoming SFTR regulation to encourage automation in this very manual market. We are expanding RFM from swaps to other rates products and maximizing the value of our data—during the quarter we introduced the TW-ICE CMT rates for market comment. Innovation remains critical to everything we do at Tradeweb and we continue to work tirelessly to move markets forward.

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

BOB WARSHAW (Slide 9-13)

Thanks Billy and good morning.

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 9.

- After posting record ADV last quarter across all asset classes, momentum in the business continued as we saw record ADV in global cash credit, and posted our 2nd highest ADV across global cash rates, repo, and equities.

We reported quarterly total ADV of $778 Billion, up 3% with a mix of growth products, for example mortgages, Swaps over 1 year, US credit, CDS and ETFs that supported double digit revenue growth.

Slide 10 provides a summary of our quarterly earnings performance.

- The volume growth I just described translated into gross revenues increasing by over 11.4% on a reported and nearly 11.8% on a constant currency basis. We derived ~34% of our revenues from international customers and recall that ~30% of our revenue base is denominated in currencies other than dollars, predominantly in Euros.
- Our variable revenues increased by 17% and our total trading revenue increased by 12%.
- Fixed revenues related to our 4 major asset classes continued to grow as expected.
- Information services increased by 5% led by Refinitiv and our APA business.
- Adjusted EBITDA margin came in at 47.8%, and expanded nicely relative to 2Q19 as we continued to benefit from scale.
- All in, we reported Adjusted Net Income per diluted share of $0.30.

Moving on to fees per million on Slide 11. The trends I am about to describe are driven by a mix of the various products within our four asset classes.

- In sum, our blended fees per million increased 13% yr/yr; primarily as the result of mix shift away from lower FPM short tenor swaps; Excluding lower fees per million short tenor swaps and futures, our blended fees per million was up 8% yr/yr.
- Let’s review the underlying trends by asset class—all trends will be discussed on a year over year basis.
- Starting with rates
    - Average fees per million for rates was up 10% yr/yr overall.
    - For cash rates products, which include government bonds and TBAs, fees per million increased 5% due to positive mix shift in mortgages which saw more in-comp institutional activity during the quarter.
    - For long tenor swaps, fees per million stayed relatively flat yr/yr. The sequential decline was due to a normalization in compression activity.
    - In other rates derivatives, which includes rates futures and short tenor swaps, average fees per million increased 168% yr/yr due to growth in FRAs which carry a higher fees per million than overnight index swaps.
- Continuing to credit
    - Average fees per million for credit declined 13% as a result of mix that included a higher proportion of lower fee per million credit derivatives volumes.
    - Drilling down on Cash Credit, average fees per million increased 3% due to positive mix shift towards U.S. HG and HY activity, which carries a higher fees per million than the cash credit average.
    - Looking at the Credit Derivatives and electronically processed US Cash Credit category, FPM decreased 5% on higher volume tier discounts due to growth in credit derivatives.
- Continuing with equities
    - Total asset class and cash equities fees per million were relatively unchanged.
    - Equity derivatives average fees per million decreased 32% due to mix shift towards Equity futures which carries a lower fees per million than the equity derivatives average.
- Finally within money markets
    - Fees per million decreased 12%.
    - This was primarily driven by growth in repo which carries a lower fees per million than other money market products.

Slide 12 details our expenses

- At a high level, we continue to invest for growth—there has been no change to our philosophy here.
- As a reminder, Adjusted Expenses excludes non-cash stock-based compensation expense related to options issued primarily as a result of the IPO, Acquisition and Refinitiv related D&A and certain FX related gains and losses.
- Adjusted Expenses for 2Q increased 6.9%. Recall ~15% of our expense base is denominated in currencies other than dollars, predominantly in Sterling.
- 2Q20 operating expenses were higher as compared to 2Q19 due to increased employee compensation costs and technology and communication expenses partially offset by lower G&A.
- Compensation costs were higher year on year due to higher headcount, as well as higher performance related compensation.
- Adjusted non-comp expense declined 1.1% on a reported basis and declined 2.2% on a constant currency basis.
- Specifically, general and administrative fees declined primarily due to less travel and entertainment expense. As we continue to work from home, we expect G&A to trend between $7-8 million per quarter during the back half of 2020. Longer-term our level of spend is under review.
- Technology and communication costs increased primarily due to higher clearing and data fees as a result of higher trading volumes as our anonymous credit volumes and streaming U.S. Treasury volumes continue to grow. In addition, this quarter also saw the impact of our previously communicated investments in data strategy and cyber security—recall our guidance embeds a $4-5 million increase versus 2019.

Slide 13 details capital management and our guidance

- First on our cash position and dividend policy
  - We ended 2Q in a strong position, holding $560 million in cash and cash equivalents and free cash flow reached $353 million for the trailing twelve months.
  - We have access to a $500 million revolver, that remains undrawn as of quarter-end
  - Capex and capitalized software for the quarter was $10.8 million, an increase of 15% year over year, and continues to be 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
  - Given the delay of our New York real estate decision to 2021 and reduced T&E expenses as a result of the work from home environment we now expect adjusted expenses to trend between $495 and $505 million in 2020.
  - We continue to believe we can drive operating margin expansion compared to 2019 at either end of this range.
  - For forecasting purposes, we are using an assumed non-GAAP tax rate of 22% for the year.
  - We also expect capital expenditures and capitalized software to be in the range of $45 - $50 million.
- Finally, 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. The secular trends powering electronification and automation remain intact. We have an exciting plan that we are executing against across our asset classes, and our diversity affords us a variety of opportunities to improve client workflows. Driving strong revenue growth and balancing associated investments with margin expansion continues to be our priority.

With a couple of important month-end trading days left in July, cash and derivatives volumes across all our asset classes with the exception of rates derivatives are up double digits relative to July 2019. Rates derivatives are down double digits given the lack of volatility and flatter yield curve —similar to conditions we saw last month. These same conditions are benefiting our mortgage business and Fed issuance continues to help our U.S. Treasury business. Overall electronic IG and HY credit market shares are running higher than June 2020 levels.

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

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 10:00 am Eastern time. Operator, you can now take our first question.

THANK YOU

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