Tradeweb 1Q23 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 1Q23 Earnings Call webcast.

OPERATOR

Good morning and welcome to Tradeweb's first quarter 2023 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 Treasury, FP&A & 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 Billy Hult, who will review the highlights for the quarter and provide a brief business update, our President Tom Pluta, who will dive a little deeper into some growth initiatives and our CFO Sara Furber, who will review our financial results. We intend to use the website as a means of disclosing material, non-public information and complying with our disclosure obligations under Regulation FD.

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 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, presentation and periodic reports filed with the SEC.

In addition, on today's call we will reference certain non-GAAP measures as well as certain market and industry data. Information regarding these non-GAAP measures, including reconciliations to GAAP measures, is in our earnings release and presentation. Information regarding market and industry data, including sources, is in our earnings presentation.

To recap, this morning we reported GAAP earnings per diluted share of $0.42. Excluding certain non-cash stock-based compensation expense, acquisition-related transaction costs, acquisition- and Refinitiv-related D&A and certain FX items, and assuming an effective tax rate of 24.5%, we reported Adjusted Net Income per diluted share of $0.54. 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 Billy.

PART II: OVERVIEW & FINANCIAL RESULTS

BILLY HULT (Slide 4-7)

Thanks, Ashley. Good morning everyone, and thank you for joining our first quarter earnings call.

The market dynamics during the first quarter were chaotic as our clients juggled continued Fed hikes, dramatic moves in the yield curve, the highest level of rate volatility since the global financial crisis and their own version of fixed income March madness with the regional bank liquidity crisis and resulting market turmoil.

Ultimately, the environment led to a mixed bag for our first quarter results --we had some strong days but also many softer ones as the extreme volatility and lack of conviction led to clients reducing risk. We also saw some migration, albeit reluctantly, to the phone during moments of high stress in March. The reality is that electronic trading hasn't solved everything yet and that is our opportunity. This is what we have been solving for and chipping away at for many years by innovating with new protocols, connecting markets and enhancing available data. Amidst this challenging macro backdrop, our dialogue with our clients remains at exceptionally high levels. We believe that the demand for fixed income products will increase, and risk taking will return as central banks enter, what is expected to be, the final innings of the current rate hike cycle.

Turning to slide 4, record first quarter revenues of $329 million were up 5.7% yr/yr on a reported basis. Stripping out 180 bps of FX headwinds, we generated revenue growth of 7.5% on a constant currency basis. The revenue growth and the resulting scale translated into 13% adjusted EPS growth and improved profitability relative to full year 2022 as our Adjusted EBITDA margin increased by approximately 37 basis points to 52.3%.

Turning to slide 5, the diversity of our growth was on display once again this quarter, marked by record revenues across Rates, Credit, Money Markets and Information Services.

Rates and money markets led the way, accounting for 57% and 18% of our revenue growth, respectively, while credit provided 15% of the growth. Specifically, the rates business was driven by continued growth across global government bonds and swaps. Credit was led by strong U.S. corporate credit and Muni trading, while equities was powered by U.S. institutional ETFs. Money markets set a new revenue record fueled by growth in our retail CD franchise and continued organic growth in institutional repos. Finally, information services revenues were driven by proprietary third-party data products, which continue to enjoy robust growth. We believe market data, especially the way it gets incorporated into trade execution to make the search process smarter, is going to become increasingly more important in the future. We also have a great partner in LSEG to help us distribute our data more broadly.

Turning to slide 6—I will provide a brief update on two of our main focus areas — U.S. Treasuries and ETFs and turn it over to Tom to dig deeper into U.S. credit and global interest rate swaps.

Starting with U.S. Treasuries—revenues increased by 15% yr/yr despite industry volumes declining slightly. Interestingly, industry institutional volumes actually grew 9%, but was more than offset by a 22% pullback in industry wholesale volumes as PTFs reduced risk-taking. Zooming in on Tradeweb--the attractive rate environment continued to propel our retail business, while our institutional and wholesale channels grew despite the challenging volatility backdrop. Specifically, first quarter institutional average daily trades rose to record highs, up 50% yr/yr, with hedge funds and banks being particularly active. Automation continued to be an important theme with U.S. Treasury AiEX average daily trades increasing by more than 100% yr/yr.

Turning to our wholesale business, our legacy streaming offering and our session business outperformed while our CLOB business underperformed the industry as elevated volatility benefited the incumbent. Last month we achieved the final technology milestone with respect to the integration of the NFI acquisition as we successfully completed the migration of our matching engine to a strategically located data center. The team continues to focus on improving the liquidity pool on the CLOB by on-boarding new clients and enhancing our overall offering. Stepping back, we think our blend of different customers and protocols and track record of innovation gives us a lot of optionality to continue to lead the evolution of U.S Treasury electronic trading.

Within equities, our decision many years ago to invest in our ETF business continues to pay dividends. Our institutional business, particularly in the U.S., continued to grow and add clients during the quarter despite slower industry volumes. With ETFs, especially fixed income funds, playing an increasingly important role in portfolio management, our value proposition has never been stronger. Other initiatives to expand our equity brand beyond our flagship ETF franchise are also bearing fruit with momentum continuing in equity options, convertibles, and ADRs. Moreover, our recent launch of iNAV calculations for ETFs in Europe, with immediate adoption by Blackrock, is another example of how we collaboratively innovate with our clients as we strive to improve the ETF ecosystem. Looking ahead, the client pipeline remains strong as the benefits of our electronic solutions continue to resonate. We believe we are well-positioned to capitalize on the secular ETF growth, not just in equities, but across our fixed income business.

Turning to slide 7 — As I think about one of the next chapters of Tradeweb, building our international presence beyond Europe is a key strategic priority. Areas of focus include APAC and EM.

In that vein, yesterday we were excited to announce our intent to acquire Yieldbroker-- a leading Australian government bond and interest rate derivatives trading platform covering the institutional, wholesale, and primary markets. We believe this potential acquisition would allow Tradeweb to further expand our client base and grow our Asia Pacific footprint. On the client front, this would deepen our penetration into the hedge fund, dealers, and asset management communities. We are particularly excited that this acquisition would let us offer Australian superannuation funds, the world's 5th largest holder of pension assets, a seamless platform for domestic and international OTC trading. Financially, we believe there are meaningful synergies and also an opportunity to cross-sell our products upon integration of our platforms. The potential deal remains subject to Yieldbroker stockholder approval, final definitive documentation, and would be subject to customary closing conditions and regulatory reviews.

The other dimension of our international expansion is our effort to build a substantial EM business. Looking back, many years ago we decided to really invest and build out our European presence by launching new European products and cross-selling existing products to European traders. Today we are one of the leading platforms for fixed income in Europe with a deep dealer and client network. We believe that the formula for EM is remarkably similar.

To this end, we recently appointed our first Head of Emerging Markets and we have already gotten to work expanding our product offering and network. The reality is that despite all the success we have had as a company, we have a great opportunity to leverage our product offering to also develop a strong EM brand. With a rapidly growing addressable market in excess of $1 billion and low levels of electronification, we believe that the broader EM opportunity is substantial. We will be focused on both EM rates and credit, and we believe our ability to provide clients with the ability to trade both developed and emerging market instruments on one platform will be a differentiator.

With respect to EM credit, the competitive dynamic is very similar to US credit when we entered several years ago—we believe the market needs and wants competition. We are focused on complementing our first forays into EM through interest rate swaps in rates and portfolio trading in credit with a complete product set. Our interest rate swaps offering complements our local currency bond roadmap, providing local dealers with the opportunity to provide liquidity in local currency bonds and hedge rate risk in developed markets.

We are currently investing in the team and technology, adding currencies and onboarding dealers and clients. An early differentiator is our collaboration with FXall, which we expect will go live in the coming months. We believe we have a promising pipeline of innovations and enhancements which should help further digitize voice workflows for our clients. This will be a multi-year initiative and we look forward to reporting on our progress in the coming quarters.

With that I will turn it over to Tom to talk about another promising growth initiative in munis, and provide our usual updates on corporate credit and interest rate swaps.

TOM PLUTA (Slide 8-10)

Thanks Billy.

Starting with munis on slide 8, we have amassed a strong presence in the tax-exempt space over the years by building and subsequently leveraging our retail platform to launch an institutional offering. Today, with nearly $50 million in annual revenues, and over 25% revenue growth in the first quarter, we are a leader in tax-exempt munis which represent 80% of industry volumes.

Looking ahead, we are adding another dimension to our growth algorithm by expanding our institutional muni presence into the taxable muni space, having already completed a soft launch in the first quarter. We are approaching this market by playing to our strengths—like IG bonds, taxable munis trade at a spread to a U.S. Treasury. We believe we can leverage our leading position in net spotting, as well as AiEX and portfolio trading, to make inroads here. On the data front, we continue to invest to improve our muni AiPrice offering, by leveraging the fact that 1 in every 5 muni trades is done on Tradeweb, to dynamically predict prices for approximately 1 million muni bonds.

We currently only have approximately 3% of the overall volume pie while electronification hovers in the 10-15% range. We believe a 1% gain in muni market share can add over $10 million in incremental annual revenues, so remains a sizeable revenue opportunity ahead of us.

Global Credit

Turning to slide 9 for a closer look at Credit. While our global credit business set another quarterly revenue record, underlying trends were mixed. Growth in munis and U.S. corporate credit was partially offset by softer overall industry trends in Europe, China and CDS, coupled with FX headwinds. Despite this mixed backdrop, automation continued to surge with global credit AiEX average daily trades increasing 60% yr/yr.

Honing in on U.S. corporate credit, the business grew 7% yr/yr, with revenue growing across all three client channels. Normalizing for the duration-related yr/yr FPM headwinds in our institutional IG business, U.S. credit would have grown by 12% yr/yr. Our institutional business was a tale of two cities—robust double-digit revenue growth in investment grade but lower HY revenues given the pullback in market share. Looking at the underlying protocols, our primary focus on growing institutional RFQ continues to pay off with volumes growing 18% yr/yr while portfolio trading volumes hit another record, growing 14% yr/yr. Retail credit revenues remained robust and also grew double-digits as advisors continued to allocate more towards fixed income.

AllTrade produced a record quarter with over $130 billion in volume. Our all-to-all volumes saw over 100% yr/yr growth aided in part by our growing dealer-RFQ business. The team continues to be focused on broadening out our network and increasing the number of responses on the AllTrade platform. In the first quarter, the number of anonymous responses grew by over 90% yr/yr. Our sessions ADV grew over 20% yr/yr and had a record revenue quarter despite the reduced match rates in March with the spike in volatility driving one-way flow. With that said, match rates started to normalize as we ended the month.

Moving onto the Aladdin partnership, we made meaningful progress in the quarter, specifically around integration of our AiPrice data and dealer inventory/axes and look forward to the integration helping our A2A responding effort and continued AllTrade network growth. Looking ahead, US credit remains our biggest focus area and we like the way we are positioned to blend liquidity across our three client channels as we work to further electronify the market.

Global Swaps

Moving to global swaps on slide 10, the environment in the first quarter can be described as one with strong client activity despite a risk-off environment. The multi-year growth story continues as our first quarter variable swaps revenues rose 5% yr/yr despite a pick-up in compression volumes and a 16% reduction in duration. Market share rose to 15.3% with record share across dollar and EM-denominated swaps.

The strength of our global swaps franchise has been the team's focus on innovation and client service. Our client focus contributed to a 56% increase in our institutional average daily trades. Our clients are not only managing extreme rate volatility, but they are also progressing through the risk-free-rate transition with trading in $ LIBOR ending this June. The combination of these two factors drove a 54% yr/yr increase in >1-year compression and switch trade related volume. We continue to expect that these clients will transition back toward risk trades.

Finally, we continue to make progress across emerging markets swaps and our rapidly growing RFM protocol. We saw record EM share in the first quarter with revenues increasing over 100% yr/yr, and we believe there is still a lot of room to grow.

Looking ahead, we believe the long-term swaps revenue growth potential is meaningful. With the market still only 30% electronified, we believe there remains a lot that we can do to help digitize our clients' manual work flows while the global fixed income markets and broader swaps market grow.

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

SARA FURBER (Slide 11-16)

Thanks Tom 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 11.

We reported first quarter average daily volume of nearly $1.4 trillion, up 16% yr/yr, and up 11% when excluding short tenor swaps. Among the 22 product categories that we include in our monthly activity report, 8 hit quarterly records while another 4 achieved their 2nd highest quarterly ADV. Perhaps even more notable, 7 of the 22 product areas produced year-over-year volume growth of more than 20%. Areas of strong growth include European government bonds, global swaps, U.S. investment grade credit, munis, and repos.

Slide 12 provides a summary of our quarterly earnings performance.

- The 1Q volume growth translated into gross revenues increasing by 5.7% on a reported basis and 7.5% on a constant currency basis. We derived approximately 37% 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 7.6% and our total trading revenue increased by 5.8%.
- Total fixed revenues related to our 4 major asset classes were down 0.8% and up 1.4% on a constant currency basis.
    - And other trading revenues were up 16% -- as a reminder, this line fluctuates as it reflects revenues tied to periodic technology enhancements performed for our retail clients.
- This quarter's adjusted EBITDA margin of 52.3% increased by 37 bps on a reported basis, and 30 bps on a constant currency basis, from the full year 2022.

Moving on to fees per million on Slide 13 and a highlight of the key trends for the quarter. **You can see the FPM Commentary on slide 18 of the earnings presentation for additional detail regarding our FPM performance this quarter.**

- Overall, our blended fees per million decreased 8% yr/yr, primarily as a result of a mixed shift away from Cash Credit, and a decrease in long tenor swaps fee per million. Excluding lower fee per million short tenor swaps and futures, our blended fees per million were down 4%.
- For cash rates products, fees per million were up 24%, primarily due to a positive mix shift towards U.S. Treasuries especially in our retail channel.
- For long tenor swaps, fees per million were down 23% primarily due to a 16% lower duration and an increase in compression trades which more than offset growth in EM swaps and RFM.
- Drilling down on Cash Credit, average fees per million decreased 1% due to a mix shift away from fully electronic U.S. high yield mostly offset by strong growth in Munis.
- For cash equities, average fees per million increased by 16% due to a positive mix shift towards higher fee per million institutional U.S. ETFs.
- Finally, within money markets, average fees per million increased 20% driven by a mix shift towards U.S. CDs and away from global repos.

Slide 14 details our expenses

- Adjusted Expenses for 1Q increased 4.5% on a reported basis and 6.4% on a constant currency basis.
- Compensation costs decreased 0.4% due to lower payroll taxes and accruals for performance-related variable compensation, which offset increases in headcount and salaries.
- Professional fees increased 34.5% mainly due to higher legal costs in connection with regulatory and compliance matters, including periodic information requests, as well as higher technology consulting expenses.
- Technology and communication costs increased primarily due to higher data fees, and our previously communicated investments in data strategy and infrastructure.
- Adjusted general and administrative costs increased primarily due to an increase in travel and entertainment. In addition, favorable movements in FX resulted in a $1.3 million gain in 1Q23 versus a $1.1 million gain in 1Q22.

Slide 15 details capital management and our guidance, which remains unchanged

- On our cash position and capital return policy
    - We ended 1Q in a strong position, with $1.2 billion in cash and cash equivalents and free cash flow reached approximately $600 million for the trailing twelve months.
    - Our net interest income of $12.5 million increased due to a combination of higher cash balances and interest yields. This was primarily driven higher by recent Fed hikes and more efficient management of our cash.

- Capex and capitalized software development for the quarter was $16.7 million, a decrease of 7% year over year, primarily due to timing of our investment spend.
- With this quarter's earnings, the Board declared a quarterly dividend of $0.09 per Class A and Class B share.
- We spent $23 million under our regular share buyback program offsetting dilution, leaving $252 million for future deployment at the end of the quarter.

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

BILLY HULT

Thanks, Sara.

As I think about the next chapter of Tradeweb, we are laser focused on continuing to invest to grow many of our flagship businesses like swaps, U.S. Treasuries and credit that we believe collectively have a lot of runway ahead of them. We will also be placing more bets on the table, be it organic initiatives like EM and taxable munis that we described today, or using M&A in a disciplined fashion. Strategically, with our multi-client sector presence, we are in a unique position to help our clients find the other side of a trade by blending and linking our wholesale, institutional and retail liquidity pools like we have done so far in credit. We also have an opportunity to continue to monetize our data primarily via our partnership with Refinitiv and also by building out our suite of proprietary solutions.

With a couple of important month-end trading days left in April which tend to be our strongest revenue days, we are seeing mid-single digit growth across the firm's ADV, though these are currently being driven by lower fee per million products. April has seen a slower start across industry volumes, partially due to the timing of the religious holidays and the continuation of elevated volatility in the market. Our IG share is higher than 1Q levels while HY share is close to 1Q levels.

I would also like to welcome Troy Dixon to our Board of Directors, who joined our Board as of March 1. Troy brings more than 30 years of financial services expertise, global leadership and human capital experience to our Board, while also increasing our Board's independence and diversity. We are delighted to have the benefit of his deep industry knowledge on our Board.

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 the record quarterly revenues and volumes at Tradeweb.

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

ASHLEY SERRAO

Thanks Billy. 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 10:30 am Eastern time. Operator, you can now take our first question.

THANK YOU

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