Tradeweb 1Q21 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 1Q21 Earnings Call webcast.

OPERATOR

Good morning and welcome to Tradeweb's first quarter 2021 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 first 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 2021 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. Please see our posted earnings presentation for more details.

To recap, this morning we reported GAAP earnings per diluted share of $0.33. 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 22.0%, we reported Adjusted Net Income per diluted share of $0.43. 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 for joining our first quarter earnings call.

For more than 20 years, Tradeweb has been driving and responding to changes in electronic OTC trading across rates, credit, equities and money markets. We have done this by harnessing the creativity of our people, redefining the limits of our technology, and collaborating with our customers to solve trading challenges that have only become more complex over time. As a result, we have developed a broad and global network that continues to grow and be central to our "connect the dots" strategy of linking our markets with the goal of ultimately increasing efficiency for our customers.

The word 'unprecedented' has been used numerous times to describe the year that unfolded in 2020. Not for a lack of imagination, but because it genuinely captures a period of great change that made everyone re-evaluate and, in many cases, re-invent the way we think and operate. At Tradeweb, our response was once again partially shaped by our people and technology, as our team migrated to a virtual world that largely persists even today. Our response was also driven by the diversity of our network that allowed us to listen to and collaborate with our clients across the spectrum—we believe the value of a multi-asset class, multi-sector, multi-protocol and global network has never been greater.

Historically, exogenous changes like the acceptance of the internet or the waves of regulation in the financial markets that have been unfolding globally have all proven to be catalysts for digitization. We believe the behavioral changes induced by the pandemic have accelerated the trajectory of electronification and digitization which continue to be multi-year secular trends in the making. It was only back in March of 2020 when Tradeweb posted its first trillion-dollar average daily volume month in an environment that we can say was extremely volatile across all asset classes. Fast forward 12 months, and we have started 2021 by posting three consecutive record months of average daily volume in excess of $1 trillion in an environment where volatility is still relatively subdued. This is a testament to the growing adoption of our electronic solutions and trading more generally by our clients.

Turning to slide 4, the acceleration of digitization I just described was on display as we reported another record quarter with volumes climbing to new highs across many of our products. Specifically, record gross revenues of $273 million during 1Q21 were up 16.5% yr/yr on a reported basis and 13.9% on a constant currency basis. The revenue growth and the resulting scale translated into improved profitability yr/yr as our first quarter Adjusted EBITDA margin expanded by 97 basis points to a record 52.0%.

Turning to slide 5, this quarter was marked by strong performance across many of our asset classes with credit leading the way accounting for more than 50% of our revenue growth. Specifically, credit posted another record quarter, with revenues growing 37.8% yr/yr as the business set new quarterly records for U.S. electronic investment grade and high yield trading. Rates revenues increased 13.4%, as cash rates posted its highest revenue and volume quarter driven by record central bank issuance which continues to fuel global government bond trading, and the low interest rate environment which drove record mortgage revenues. Swaps revenues hit a new record driven by continued market share gains. Equities fell by 2.9% as a decline in our more volatility sensitive wholesale ETF business more than offset institutional growth and our efforts to diversify beyond ETFs. Money markets revenues were down 3.5% as continued strong rate headwinds in the retail sector more than offset the organic growth in institutional repo. Finally, market data was up 7.6% driven by growth in both our Refinitiv re-distribution license and proprietary data products.

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 which is our largest and fastest growing rate product— a more challenging macro backdrop relative to last year was more than offset by our organic growth efforts. We continue to attract new clients and deepen our client wallet share by driving higher engagement and introducing new products and protocols—this led to overall swaps volumes growing by 15%. As a result, swaps market share increased to a record 11.8% as measured by Clarus. We believe we continued to gain meaningful share versus our closest competitor Bloomberg in both the U.S. and Europe. Longer-term, we remain excited by the multi-year opportunity here as the rate cycle improves and the market continues to electronify. Billy will give you an update on our strategy in a few minutes.

Moving on to U.S. Treasuries— another rates product that continues to set records, our volumes increased by 23% yr/yr led by both the institutional and wholesale business pushing market share to a record 15.3% of the U.S. Treasury market. The backdrop of heavy issuance continues to support the institutional channel, whereas, the return of debate surrounding the trajectory of interest rates was particularly beneficial to the wholesale channel relative to the fourth quarter. Focusing on what we can control, institutional share gains have been driven by existing clients doing more business, competitive share gains versus Bloomberg and further inroads into the T-bill market, capitalizing on the recent wave of short-dated issuance. Looking ahead we are also investing in driving the adoption of our early-stage streaming protocols like Tradeweb+— volumes here rose substantially versus last year.

Our wholesale U.S. Treasury offering, which today is centered on disclosed streams and session trading, posted another record quarter. Following a string of new client wins, we have now become a leading streaming venue, as our efforts to lead with proprietary technology and really understand what our clients want pay off. While streams continue to see rapid adoption, we believe the central limit order book or CLOB will remain an important protocol. In response to client demand for more protocol choice and the competition in the CLOB arena, we announced the acquisition of Nasdaq's U.S. fixed income platform which we expect to close later this quarter. As a result, our clients will have the ability to complement their streaming activity with a liquid CLOB. We will also be able to lower their connectivity costs, and enhance our U.S. Treasuries data offering with depth of book data. As a reminder, we believe we can improve EBITDA margins to Tradeweb's adjusted EBTDA margin or higher exiting the first year of a two-year integration period while being immediately accretive to adjusted earnings on closing.

Looking ahead, we believe the mix of our organic and inorganic growth initiatives and the growing pool of U.S. Treasuries outstanding courtesy of the Fed's ever-expanding deficit bodes well for earnings power as we continue to emerge from this pandemic into an increasingly higher and more volatile interest rate environment.

Shifting to Credit, this was another great quarter as our business continues to surge ahead generating more than $74 million in revenues to start the year. As I wrote in my recent Shareholder letter, it's amazing to see us hit the 10% electronic share milestone consistently in IG credit, six years into our journey. And now it's encouraging to see the progress being made in HY as well. Our differentiated approach, where we not only continue to redefine institutional electronic trading with innovations like portfolio trading, AllTrade and net spotting, but also focus on the entire credit market with other innovations like session trading and ReMatch, is resonating strongly with clients. Looking ahead, we continue to see a lot of opportunity in credit as our platform continues to scale, and as the retail business recovers. Billy will give you an update on our strategy momentarily.

Finally, within equities, institutional ETFs produced a record quarter with ADV up 13% yr/yr as new client wins more than offset the substantial pullback in US & European ETF industry activity. During the quarter, equity ETFs comprised 63% of our global volume with fixed income contributing 30%. Fundamentally, we continued to add new clients globally and remain excited about the prospects for the business. Our other initiatives to expand beyond our flagship ETF franchise are also bearing fruit with momentum continuing in equity options, convertibles, and ADRs. Looking ahead, we believe we remain well-positioned to benefit from the continued growth in ETFs globally, with our newer product additions, expanding client footprint, and further AiEX product enhancements. And together with portfolio trading, index CDS, and most recently total return swaps, our passive trading electronic solution set allows clients to take macro views in an efficient manner across asset classes and products.

With that I will turn it to Billy.

BILLY HULT (Slide 7-8)

U.S. Credit

Thanks Lee. Turning to slide 7 for a closer look at Credit.

We produced another record-breaking quarter driven primarily by the continued rapid growth of our U.S. institutional corporate credit trading business. Clients are voting for the liquidity and innovation we have brought to the market by increasing their trading on Tradeweb. While the past few quarters has been about the rapid progress we have made in IG, the tide is now turning in HY where we also had a record quarter.

Our fast-growing wholesale and retail middle market businesses were also important contributors. Recall, middle markets is an important business where institutional traders trade in smaller sizes. Conditions in our core retail business have improved slightly with the recent steepening of the yield curve. However, they still remain challenged relative to 1Q20 as financial advisors remain reluctant to add lower yielding municipal and corporate bonds to their client's portfolios.

Looking back, when we set out to bring meaningful competition to the U.S. corporate credit market, we had a clear strategy centered around creating a powerful feedback loop led by serial innovation, converging different sectors in the credit market and creating novel electronic and digital solutions for our clients. We believe our strategy is resonating loudly with clients as our market share continues to set new records. While we are pleased with the progress made so far, we strongly believe we have the potential to do even better.

We believe our technological innovation is permanently influencing client trading behavior. The latest example being portfolio trading, a light bulb solution which continues to attract more clients globally. Tradeweb facilitated a record $70B in portfolio trades in the first quarter of 2021, with ADV up more than 150% year over year, highlighted by record activity both in the U.S. and internationally. In the U.S., we estimate that industry portfolio trading now regularly comprises 4-5% of TRACE versus 2% at the beginning of 2019.

The numbers show portfolio trading has quickly become the next big protocol in credit after RFQ and all-to-all. Clients are increasingly turning to portfolio trading to discover prices for bonds with low liquidity scores and move large amounts of risk and take advantage of hit rates and quote rates in excess of 90%. The certainty and speed of execution has been game changing. Behaviorally, clients are increasingly putting dealers in competition--our in-comp portfolio trading volumes have tripled from last year. Moreover, the size of their trades is growing, with the number of line items increasing to record levels. The demand continues to surge and we will soon be rolling out our next generation of portfolio trading.

AllTrade, the broadest suite of anonymous protocols on the market today connecting liquidity between our three client sectors also hit a new record. Clients traded over $82 billion, an increase of nearly 100% yr/yr, as our investments to grow our all-to-all network, integrate AiEX and improve responding functionality continue to pay-off. Session trading, another key AllTrade protocol, also hit a new record. Our newest innovation ReMatch, which enables unmatched inquiries at the end of a wholesale session to be matched by our institutional all-to-all platform as well as by offsetting retail liquidity, is still early in its rollout, but the progress has been encouraging.

Our advanced net spotting offering saw another record quarter with over $117 billion in volume, up 73% yr/yr. We rolled out our Multi-Client Net Spotting offering in the quarter, which we believe greatly advances our existing offering and are onboarding a strong pipeline of clients. Clients will now be able to net their hedging activity not only across dealers but also across other clients at the same time, enhancing savings, trading and operational efficiency. This is the 4th iteration of our net spotting offering, and we believe that further extends our lead against competitors today with basic spotting functionality.

Turning to the rest of our credit business, we believe one of our strategic advantages lies in the diversity of our product set. We achieved record revenues across European Credit, China Bonds and institutional Munis.

Our CDS business, posted its second strongest quarter on record though volumes fell 35% yr/yr as volatility subsided from the extraordinary levels that we saw last year. We remain focused on driving our share higher by expanding our product set with strong growth in our EM sovereign and single-name CDS. We also recently expanded our product offering with the first ever electronic Markit iBOXX total return swap trade. This is just another example of us collaborating with our clients to bring needed efficiency and transparency to the fixed income ecosystem.

In sum, we believe our credit business has tremendous room for growth and we have an exciting roadmap to lead the innovation across the credit markets. We are arming traders across the marketplace with a variety of protocols to intelligently find liquidity and optimize their execution objectives.

Global Swaps

Moving on to swaps, the multi-year growth story continued with record first quarter results. Variable revenues grew by 30% driven by market share climbing to a record 11.8% from about 7% last year. This is a remarkable accomplishment by the team at Tradeweb in light of 1Q last year when volatility back then couldn't have been more supportive. The success in swaps is another example of the non-stop innovation that has become a hallmark of our culture.

The low interest rate and volatility environment pressured industry volumes in the quarter which were down 29% yr/yr. The lower industry volumes were primarily driven by a decline in lower fee per million overnight index swaps (OIS). However, client debate has returned regarding inflation expectations and the shape of the yield curve which has injected life into volumes relative to the fourth quarter of 2020.

Over the last few calls, we have talked about focusing on the things in our control. Specifically, driving market share higher by innovating to expand across products, protocols and geographies. Our record market share was driven by gains within core IRS, our main market of focus, and FRAs, where our combined share across core IRS and FRAs rose to 12.0% from 6.9%. We continue to innovate by responding to structural changes in the swaps market, be it the growth of EM swaps clearing or the transition to alternative reference rates and introducing new products and protocols. In fact, in the first quarter, we saw record EM and RFM activity, the first electronic cross currency swap executed at LCH SwapAgent, and the first automated Euro swap vs. Bund futures trade. And last week, we added Brazilian IRS as we continue to attack the growing EM opportunity.

Looking ahead, recall the swaps market was the last big rates market after government bonds and TBA markets started to go electronic in a meaningful way. And that only happened a few years ago at a time when the corporate credit market was well and truly on its way to being more electronic. Since then, the market has quickly electronified to approximately 25% today. There still remains a considerable amount of business done via voice and that's our opportunity—innovating to digitize manual flow while the global fixed income markets and broader swaps market continue to grow.

AiEX

Finally, we continue to invest in our leading automated trading capability, AiEX. Adoption continues to increase as clients get increasingly comfortable with low to no-touch trading. The number of AiEX trades grew by 56% yr/yr in the first quarter with record usage across Rates, Credit and Equities.

Clients love the data-driven intelligence that AiEX is able to provide, especially when it comes to counterparty selection. Post-trade, they can use it as a series of metrics to assess the performance of their key counterparties and continue to fine-tune their trading strategies. This is really resonating with clients. And as clients become more comfortable with automation, we believe they will increasingly automate more of their trades and focus on more complex trades and managing client relationships.

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

BOB WARSHAW (Slide 9-14)

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.

We reported record quarterly average daily volume in excess of $1 trillion, up 18% both including and excluding short tenor swaps. Among the 20 product categories that we publicly disclose in our monthly activity report, 13 hit quarterly records while another 5 achieved their 2nd highest quarterly ADV. Areas of notable growth include US and European government bonds, mortgages, U.S. and European corporate credit, Chinese bonds, European ETFs, and institutional repo.

Slide 10 provides a summary of our quarterly earnings performance.

- The record 1Q volumes translated into gross revenues increasing by 16.5% on a reported and 13.9% on a constant currency basis. We derived ~39% 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 21.6% and our total trading revenue increased by 17.3%.
- Total fixed revenues related to our 4 major asset classes continued to grow, up 6.9% and 3.6% on a constant currency basis. Credit fixed revenue growth was primarily driven by the addition of new dealers in U.S. credit and additional clients in Chinese bonds. Equities fixed revenue growth was driven by the addition of new dealers and the impact of FX. Other trading revenues were up 19.8% primarily driven by periodic revenues tied to technology enhancements performed for our retail clients.
- Market data increased by 7.6% due to growth in Refinitiv and proprietary data products.
- Adjusted EBITDA margin came in at a record of 52.0%, and expanded nicely by 97 basis points relative to 1Q20 as we continued to benefit from scale.
- All in, we reported Adjusted Net Income per diluted share of $0.43.

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 5%; primarily as a result of stronger growth in higher fee per million greater than 1-year swaps, Credit, and Institutional ETFs. Excluding lower fee per million short tenor swaps and futures, our blended fees per million was up 4%.
- Let's review the underlying trends by asset class.
- Starting with rates
  - Average fees per million for rates was up 7% overall.
  - For cash rates products, which include government bonds and TBAs, fees per million was flat as growth in longer-dated and higher fee per million US Treasuries was offset by growth in institutional mortgages which carry a lower fee per million.
  - For long tenor swaps, fees per million was up 14% primarily due to growth in international clients, EM swaps and RFM.
  - In other rates derivatives, which includes rates futures and short tenor swaps, average fees per million increased 59% due to growth in FRAs which carries a higher fee per million than OIS.
- Continuing to credit
  - Average fees per million for credit increased 74% as higher fee per million cash credit products, such as U.S. and European corporate bonds, saw record volumes, while lower fee per million CDS activity declined compared to a very volatile first quarter in 2020.
  - Drilling down on Cash Credit, average fees per million increased 2% due to stronger growth in US High Grade and US High Yield, both of which carry a higher FPM than overall Cash Credit.
  - Looking at the Credit Derivatives and electronically processed US Cash Credit category, FPM increased 2% driven by growth in US High Grade electronically processed volume which carries a higher fee per million than the credit derivatives average.
- Continuing with equities
  - Average fees per million for equities was up 4% overall.
  - For cash equities, average fees per million decreased by 1% due to a decline in fee per million within US ETFs. This was driven by rising asset values inflating notional traded. Recall in the US we charge per trade and not for notional value traded.
  - Equity derivatives average fees per million increased 4% due to growth in European Convertibles which carry a higher fee per million than the equity derivatives average.
- Finally, within money markets
  - Fees per million decreased 30%.
  - This was primarily driven by growth in institutional repo, which reached record levels and continues to grow. Institutional repo carries a lower fee per million than other money market products. Retail money markets activity remained pressured by the low interest rate environment.

Slide 12 details our expenses

- At a high level, we continue to invest for growth—there has been no change to our philosophy here.
- Adjusted Expenses for 1Q increased 13.4% and 8.8% on a constant currency basis. Recall ~15% of our expense base is denominated in currencies other than dollars, predominantly in Sterling.
- 1Q21 adjusted operating expenses were higher as compared to 1Q20 due to increased employee compensation, technology and communication, G&A, and professional fees which were partially offset by lower T&E.
- Compensation costs increased 11.7% due to higher headcount, as well as higher performance related compensation and payroll related taxes.
- Adjusted non-comp expense increased 17.0% on a reported basis primarily due to technology and communications and unfavorable movements in FX. Adjusted non-comp expense on a constant currency basis increased 5.5%.

- Specifically, technology and communication costs increased primarily due to higher clearing and data fees as a result of higher AllTrade volumes in credit and streaming U.S. Treasury volumes which continue to grow. In addition, this quarter also saw the continued impact of our previously communicated investments in data strategy and infrastructure.
- Adjusted general and administrative increased primarily due to unfavorable movements in FX which resulted in a $1.5 million realized loss in 1Q21 versus a $2.3 million realized gain in 1Q20. Recall, we adjust out unrealized FX hedging gains or losses and the impact of FX on our cash balances. G&A on a constant currency basis decreased 23.4% given less travel and entertainment expense.
- Professional fees increased 15.3% due to increased consulting fees related to our investment in data strategy and infrastructure technology.

Slide 13 details capital management and our guidance

- First, on our cash position and capital return policy
    - We ended 1Q in a strong position, holding $809 million in cash and cash equivalents and free cash flow reached $473 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 development for the quarter was $12.6 million, an increase of 51% year over year, primarily due to timing of investment spend. We continue to expect capital expenditures and capitalized software to be in the range of $45 - $50 million for the full year. With this quarter's earnings, the Board declared a quarterly dividend of $0.08 per Class A and Class B share.
    - We did not repurchase any shares in the quarter because of the lag between approval and final implementation. We expect the plan to begin in the second quarter. As a reminder, we authorized a $150 million share repurchase program which we plan to use primarily to offset annual equity grants.
- Turning to other guidance items for 2021
    - We expect adjusted expenses to trend in the higher half of our previous $530 to $560 million range for 2021.
    - We continue to believe we can drive operating margin expansion compared to 2020 at either end of this range.
    - For forecasting purposes, we continue to use an assumed non-GAAP tax rate of 22% for the year.
- Finally, on slide 14, we have updated our quarterly share count sensitivity for 2021 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 operating environment still remains subdued, especially across retail, yet organic market share gains and volume increases continue to drive growth. We believe the multi-year secular trends powering electronification and automation remain intact. The regional, product and asset class diversity of our revenues was on full display with another strong quarter for credit, rates, and institutional equities, while money markets have multiple growth levers despite the noted macro challenges. Our network continues to deepen as we innovate and "connect the dots" between different asset classes, sectors, protocols, regions, and customers. We believe it is this diversity that positions us well to both participate in and lead the next generation of progress. In addition to organic growth and our previously announced Nasdaq Fixed Income acquisition, we continue to spend time evaluating potential M&A opportunities that we believe would further augment our network given our cash position.

With a couple of important month-end trading days left in April, momentum from the first quarter has continued with overall revenues and volumes up double digits relative to April 2020. We are seeing strong revenue growth across global interest rate swaps and corporate credit. Both electronic IG and HY credit market shares are running higher than last quarter with notable strength across portfolio trading and AllTrade.

Before I conclude, I would like to welcome Murray Roos and Von Hughes to our Board of Directors. We are excited to leverage their voices and experience as operators and strategists, and believe they will be immensely helpful to the board and our management team. 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 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 10:30 am Eastern time. Operator, you can now take our first question.

THANK YOU

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