Tradeweb 1Q20 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 1Q20 Earnings Call webcast.

OPERATOR

Good morning and welcome to Tradeweb's first 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 first quarter earnings release, accompanying presentation and April 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. Statements related to, among other things, our guidance, including 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's results were consistent with our recent earnings pre-announcements. Specifically, 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 22.0%, we reported Adjusted Net Income per diluted share of $0.37. 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 first quarter earnings call.

Before we begin, we'd like to acknowledge this extraordinary crisis which is unlike anything we have ever experienced before. The human suffering and loss is immense and our thoughts are with all the medical and other essential professionals on the front line and those impacted by the pandemic globally. For Tradeweb, this is the first time that a significant number of market participants and our 950+ employees in every region in which we operate have been working remotely. Our clients' amazing ability to shift trading and risk management to a virtual environment during a period of immense volatility is a testament to the rapid evolution of Wall Street driven by investments made to digitize the trading lifecycle.

But there remains plenty of room to do even more. We expect these investments to accelerate as risk management play books are re-written and inefficient manual processes are heavily scrutinized. Not having a robust and tested electronic trading strategy is no longer an option in this new era for trading. We are already seeing clients who have cautiously made investments in electronic trading demonstrate renewed enthusiasm for the efficiencies that our arsenal of solutions is able to provide across asset classes.

As the markets gradually stabilizes, Tradeweb has transitioned back from solely focusing on helping our clients trade significant risk and ensuring system stability in March, to actively developing and selling our innovations in April and so far in May. We believe a key factor leading to market stabilization has been the efforts of central banks globally who are using the government bond markets to finance their support of the fixed income ecosystem and the broader economy. We believe our solutions at Tradeweb have only become more critical to clients who currently are and we expect will continue to be very active in absorbing the trillions of forthcoming government bond issuances as deficits widen especially in the U.S. and Europe.

We remain excited by the opportunity ahead of us. We have navigated a variety of challenging environments over the years but we believe that we have never been in a position where the diversity of our business model has been stronger or where the array of growth opportunities has been as compelling as they are today. We also have a strong balance sheet that allows us to be opportunistic and we remain committed to delivering strong revenue growth and driving margins higher over the long term as our investments scale globally.

Overall, I feel good about our resilient business model, how we are managing the complexity of changing global conditions and how we continue to help our customers during these unprecedented times.

Turning to slide 4, we reported the strongest first quarter in our history and set multiple new volume records across our products. While the volatility in March partially drove increased trading across our platform, the investments we have been making over the years powered a strong start to the year with the volumes we saw in January setting the stage for a very strong first quarter. Looking ahead, given our healthy pipeline of investments and innovations, we look forward to helping our clients transact even more volume on our platform.

Specifically, *record* gross revenues of $235 million during 1Q20 were up approximately 26% yr/yr on both a reported and constant currency basis. Our financial performance was once again characterized by strong growth, both domestically and internationally. Our continued double-digit revenue growth and the resulting scale translated into improved profitability as our first quarter Adjusted EBITDA margin increased to a record 51.0%.

Turning to slide 5, 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 ninth consecutive quarter of double-digit revenue growth. Our other asset classes also grew by double digits with equities and money markets revenues growing by 65% and 17% respectively, on a reported basis. Our data business grew by 10% capping a strong quarter overall.

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 our largest rates product by revenue, interest rate swaps— our total volumes were up over 62% yr/yr during 1Q with swaps greater than one year in duration growing by over 12%. Overall global IRS share for 1Q increased to over 7% growing substantially year over year. We believe we gained meaningful share versus our closest competitor Bloomberg in both the U.S. and Europe especially as volatility picked up in March. Clients were able to confidently leverage our deep liquidity pools and range of trading tools including our flagship compression and newer RFM and packaged trade protocols to exchange substantial amounts of risk.

We believe the significant potential for our interest rate swaps franchise remains an underappreciated element of our story. We recognized the interest rate swaps market opportunity in the mid-2000's investing to pioneer the first electronic trading solution guided by our belief that the efficiencies that we brought to other large rates markets such as government bond markets and mortgage bond markets would also resonate with interest rate swaps traders. We were early and after the first wave of regulation led by Dodd Frank in 2013, electronification accelerated. Since then, the investments that we have made to improve our functionality, help clients navigate regulatory changes and our ability to offer trading in correlated and adjacent asset classes like mortgages and government bonds have all combined to drive significant market share gains and make us the leading venue for clients to trade interest rate swaps.

But there remains plenty to do—this is a multi-year story. Looking ahead, 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. We have also provided more pricing disclosure to help you model this opportunity going forward. Billy will provide a detailed overview of our current growth initiatives and outlook in a few minutes.

Moving on to U.S. Treasuries— our volumes were up nearly 14% yr/yr. The volatility across the curve was exceptional during the month of March. In more than 20 years of trading Treasuries, we've never seen the market try to navigate a global crisis quite like this. Amidst this challenging environment, I am pleased to report that 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 first quarter increased yr/yr to 12.5% of the entire U.S. Treasury market. Our wholesale streaming platform continues to gain traction as an alternative to the traditional order books and our list trading tools proved to be an especially popular tool to help clients navigate the volatile environment. We have not seen any meaningful impact on our volumes from the daily Fed purchases which have continued to decline as the markets have stabilized since March. As I mentioned earlier, we believe the ongoing and forthcoming wave of UST issuance to finance the widening government deficit should bode well for secondary cash trading.

Our credit business hit a new milestone crossing $50 million in quarterly revenues for the first time powered by both our cash and derivatives franchise. We saw broad-based strength across global corporate credit, municipals and CDS. Like interest rate swaps, we believe there remains plenty of runway to meaningfully grow credit revenues from here in the coming years across our products. To help you model our progress we have enhanced our FPM disclosure today so that you can better appreciate the growth potential especially within electronic cash credit which carries a considerably higher FPM than the blended rate you have been accustomed to seeing from us.

Fundamental to our credit business is our institutional credit business which today encompasses U.S., European and Chinese cash credit, U.S. municipals and CDS. These businesses collectively comprise the majority of our credit revenues and grew by 60% yr/yr during the first quarter. With that said, in our efforts to build the deepest pool of liquidity we recognize the dealer-to-dealer business is equally important as we go after the entire global electronic credit wallet across sectors. We continue to strongly believe that as electronification accelerates, we will be able to further connect the liquidity pools across all of our three customer sectors over time. Billy will provide more details on what transpired in March and our growth efforts here momentarily.

Finally, within equities, this quarter was highlighted by institutional ETFs—volumes were up 73% due to a combination of elevated volatility and our organic growth efforts. Going ahead, we remain well-positioned to benefit from the continued growth of ETFs globally and are focused on expanding our client footprint. The ETF market functioned really well during this period of volatility and proved to be a good way to transfer a large amount of risk in single transactions. Block trading ETFs through RFQ continues to see more demand, and the occasional disconnect between NAVs and prices of the ETFs did not impact our business.

With that I will turn it to Billy.

BILLY HULT (Slide 7-8)

Thanks Lee, and let me also start by acknowledging the human toll of this pandemic. Our thoughts and prayers are with all those impacted. As Lee mentioned earlier, we were able to shift swiftly and successfully to working remotely, and we are very fortunate to have a business model that can make this transition and still thrive by serving our clients. Innovation has been and will continue to be the key to our success going forward.

At a high level, as extreme volatility gripped the market in March, we saw a flight to quality liquidity, where our customers sought to transact against the best prices available. We also saw a flight to safety, where our customers used all of the tools at their disposal to make their workflows less risky and safer. Auto-execution waned especially in illiquid asset classes, as auto-quoting capabilities were paused across dealer desks. While absolute volume increased yr/yr during 1Q, we saw the percent of institutional trades executed via AiEX drop to 17% in March from over 25% in January and February. Looking ahead, as market conditions continue to improve following various ongoing and looming Fed actions, we believe AiEX will continue to grow in the future and remain a critical tool. We have already started to see a recovery in European AiEX usage in April and given the global nature of these institutional clients, U.S. activity has picked up meaningfully recently.

In this work from home environment, we have become the “virtual street” meeting customers where they are and helping them manage meaningful amounts of risk. Our salesforce and product teams are very engaged with our clients. As much as possible, the Tradeweb experience our customers had at their trading desks is the experience they are getting at home. It’s also changing how people work on our platform as clients streamline and optimize their trading processes. Straight-through processing, which is not something that normally makes headlines for us, is something that customers are relying on when they are away from their desk. We believe that these behavioral changes will be sticky. When combined with the discrete growth opportunities that I am about to discuss in swaps and credit, I continue to be very excited about the future at Tradeweb.

Global Swaps

Turning to slide 7. As Lee mentioned, interest rate swaps are one of our largest products at Tradeweb and we believe there is a lot of runway for growth. The chart on the top-left corner shows that the global IRS market today as measured by Clarus trades in excess of $3 trillion daily. We estimate electronification to be around 20-25% leaving plenty of runway for the market to catch up to other markets like U.S. investment grade credit in the 25-35% range or even European corporate credit at 50-60%.

Digging into the financials, this business grew revenues by 35% yr/yr in 1Q, marking the 9th consecutive quarter of double digit revenue growth. A significant majority of our swaps revenue is variable giving us the ability to take advantage of increasing electronification and growth of the market over time. And 99% of our revenue is generated from longer-tenor swaps in excess of 1 yr given our duration dependent fee model.

In 2019, our full year swaps share averaged nearly 8% across our products. It is important to appreciate that all swaps products are not created equal. At the bottom left corner of the slide, you can see the nuances of our swaps franchise across three products—core IRS, overnight index swaps or OIS and forward rate agreements or FRAs. In our core IRS market which includes vanilla, basis and inflation swaps—we estimate that we are the leading platform with 14% share having gained nearly 800 basis points of share over the past three years as electronification of the swaps market accelerated in response to regulation and our organic efforts. Core IRS is where 85% of the industry revenue opportunity lies and we estimate that our 14% overall share gives us 60-70% share of the electronic market. At the same time, we have grown our presence in OIS and more recently in FRAs as clients increasingly embrace electronic solutions across swaps products.

Looking ahead, in addition to building on our existing momentum in major currencies we are investing across the board to help accelerate the electronification of this market over the coming years. Specifically we are:

- Entering the Emerging Markets swaps market where we continue to invest to grow our currency footprint today. Large asset managers that are fully integrated into Tradeweb for major currencies are using the same infrastructure and working with us to further enhance their access to liquidity. We are actively onboarding dealers to provide liquidity and satisfy the demand we are seeing from clients in 2020.
- Another area of focus is expanding wholesale session trading to FRAs—we spent 2019 investing in building this offering and we just exited beta mode during the first quarter.
- We are also growing RFM, Request for Market, for interest rate swaps which helps clients hide their intent to buy or sell by requesting a two-sided market.
- Finally, we are continuing to grow our electronic solutions for historically voice traded products such as swaptions and multi asset packaged swaps. We have already traded $29 billon in multi asset packaged swaps since our launch in August last year.

So in sum, we believe the swaps opportunity is meaningful with a multi-year runway and our rates franchise is very well positioned to continue to grow anchored by swaps and complemented by the other opportunities especially in U.S. Treasuries.

U.S. Credit

Honing in on U.S. corporate credit on slide 8, where we also see a very meaningful near and long-term opportunity especially in electronic credit. Our momentum continued in the first quarter as our network and share continue to expand as our investments pay off. The unprecedented level of volatility that gripped the credit markets in March, as fears around the pandemic intensified, allowed to us to battle test many of our recent innovations and we are pleased to report that they held up really well.

Specifically, net spotting grew to a record $68 billion during the first quarter and U.S. portfolio trading also grew to a record $23 billion. With respect to net spotting, clients were able to rely on our benchmark treasury composite pricing and our deep institutional UST liquidity pool to successfully hedge their trades in a volatile environment. As clients work from home, demand here has accelerated. In addition, portfolio trading proved to be a more efficient way to trade as opposed to executing multiple RFQs and in some cases executing via all-to-all. We continue to see a lot of potential for portfolio trading globally—in our first full quarter since launch, we executed $6bn billion in volume across European and Emerging Markets corporate credit.

While March was a very strong revenue month, we saw less AiEX and institutional RFQ activity. Behaviorally, the RFQ flow we did see from clients shifted towards all-to-all execution. Consequently, our all-to-all volumes reached a new record during the first quarter.

Institutional RFQs are fundamental to our credit business and a key component of our recent growth. We've seen a rebound in RFQ activity in April and we expect to continue to grow this business as clients expand their engagement with our system. Looking ahead, we are laser focused on scaling and enriching our all-to-all network. Earlier this year, we rolled out several workflow enhancements and we have several more in the pipeline. This will be a multi-year investment and we look forward to reporting on our success as we deepen our all-to-all liquidity pool.

We also saw less volume within our fast growing wholesale session trading protocol as elevated volatility made it difficult to derive a price for each session. As the credit markets continue to recover and volatility subsides, we have started to see our session activity gradually increase towards the end of April. Session trading remains a very valuable protocol for dealers to clean up balance sheets and we believe will prove to be increasingly useful as the dust settles and dealers are left to digest record levels of issuance. Session trading, like portfolio trading, is in its early stages with a lot of potential and we are leading the innovation here.

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 CDS business, where we primarily compete against Bloomberg and MarketAxess, hit a new record as we continued to gain more market share, as measured by Clarus, and benefited from increased volatility. In addition, U.S. municipal trading also increased substantially, especially in March, as clients were able to take advantage of our deep liquidity pool as volatility intensified. As a result, our institutional muni business also reached a new volume record.

Overall, we feel really good about the growth potential in credit. We have a strong client and product pipeline and we are laser focused on executing on our various growth initiatives and launching the next wave of innovations.

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. Let me start by taking a moment to acknowledge the tragic human loss and thank everyone working to help us get through all of this. I would also like to thank my team who closed our books seamlessly in a remote environment this quarter. As Lee indicated, our continued year over year growth in volumes, revenue, earnings and improved margin in the first quarter of 2020, as well as our volumes in April, continue to give us 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 9.

- We reported record quarterly ADV of $898 billion, up 39%—as you can see the growth was broad-based.
- Our organic growth initiatives powered the bulk of the quarter especially in January and February.
- On the one hand, in March our organic efforts were amplified by seasonal strength in our derivatives products.
- On the other hand the impact of volatility was mixed—in some markets like ETFs and to a certain extent derivatives, volatility helped amplify our share gains. In other markets, extreme volatility and the imbalance between selling and buying interests especially in more illiquid markets provided its own set of challenges.
- With that said, we believe the diversity of our business is one of our strengths and we continue to invest to capitalize on the opportunities ahead of us.
- During the quarter we saw ADV records in U.S. and European government bonds, mortgages, swaps greater than 1 year in duration, global cash credit, credit derivatives, equities and repo.

Slide 10 provides a summary of our quarterly earnings performance.

- The strong volume growth I just described translated into gross revenues increasing by nearly 26% on a reported and constant currency basis. We derived ~38% 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 43% and our total trading revenue increased by 27%.
- Fixed revenues related to our 4 major asset classes continued to grow as expected.
- Other information services increased by 20% led by increased market data revenue from our APA business.
- Adjusted EBITDA margin came in at 51.0%, exceeding 50% for the first time since we went public and expanded nicely relative to 1Q19 as we continued to benefit from scale.
- All in, we reported Adjusted Net Income per diluted share of $0.37.

Moving on to Fee per Million on Slide 11. Today we are providing more color on the variable fees per million we generate on our cash and derivatives products to help you better calibrate your models. 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 increased 1% yr/yr; excluding lower FPM short tenor swaps, our blended fee per million was up 10% 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 flat overall.
    - For cash rates products, which include government bonds and TBAs, FPM increased 5% due to growth in specified pools activity in mortgages. Specified pools carry a higher fee per million than the cash rates average.
    - For long tenor swaps, FPM increased 32% yr/yr due to growth in non-compression activity. Non-compression swap protocols carry a higher average fee per million than the long tenor swaps average and fluctuate from quarter to quarter.
    - In other rates derivatives, which includes rates futures and short tenor swaps, average fee per million decreased 59% yr/yr due to growth in short tenor swaps activity, which

carries a comparatively lower FPM than futures.

- Continuing to credit
  - Average fees per million for credit declined 31%.
  - This was primarily driven by mix shift to credit derivatives given the seasonal index roll activity, organic market share gains and elevated volatility.
  - Drilling down to Cash Credit, average fees per million decreased 3% due to mix shift away from municipals driven by faster growth in the U.S. HG and HY credit products. Munis carry a higher fee per million than the cash credit average.
  - Looking at the Credit Derivatives and electronically processed US Cash Credit category, FPM decreased 6% due to higher Credit Derivatives activity driven by market volatility and organic market share gains.
- Continuing with equities
  - Total asset class and equity derivatives average fees per million decreased 27% and 58% respectively.
  - 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.
  - Cash Equities average Fee per Million decreased 12% due to growth in U.S. ETFs which carry a lower FPM than the Cash Equities average.
- Finally within money markets
  - Fees per million decreased 8%.
  - This was primarily driven by growth in repo which carries a lower FPM 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, Acquisition and Refinitiv related D&A and certain FX related gains and losses.
- Adjusted Expenses for 1Q increased 7.8% (10.7% on a constant currency basis). Recall ~15% of our expense base is denominated in currencies other than dollars, predominantly in Sterling.
- 1Q20 operating expenses were higher as compared to 1Q19 due to increased employee compensation costs.
- Compensation costs were higher year on year due to increased commission expense associated with our increased wholesale revenue, as well as higher performance related compensation.
- Adjusted non-comp expense declined 1.6% (or increased 6.5% on a constant currency basis).
- Specifically, general and administrative fees declined as the euro appreciated against the pound. This resulted in approximately a $2 million FX gain in our accounts receivable. Recall, we expense all gains and losses tied to accounts receivable and only adjust out unrealized FX gains and losses tied to our hedges and translation of our cash balances.
- On a constant currency basis, which excluded all FX gains and losses, general and administrative expenses were up 19.6%, due mostly to increased insurance expenses associated with being a public company. We expect G&A to trend around $10-$11 million a quarter excluding the impact of FX going forward in 2020.

Slide 13 details capital management and our guidance

- First on our cash position and dividend policy
  - We ended 1Q in a strong position, holding $424 million in unrestricted cash and cash equivalents and free cash flow reached $236 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 $8.4 million, an increase of 1% 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 which remains unchanged
    - We will continue to invest in 2020, and are expecting Adjusted Expenses to range from $495M - $510M. 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, 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. As I noted in my recent shareholder letter, the future for Tradeweb is bright. 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. Today's additional FPM disclosure should help shed more light on the drivers of our double-digit revenue growth and illuminate the vast potential we see for our rates and our credit businesses. We think we are very well positioned to capitalize on what we believe will be an acceleration in electronification coming out of this pandemic.

The momentum we saw to start the year has continued into the beginning of the second quarter, with April volumes increasing 15% year over year with broad-based growth across our four asset classes. The rates markets are in substantially better shape than March and the credit markets are improving gradually as market function improves.

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 first quarter in our history under very difficult circumstances.

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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