Tradeweb 3Q20 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 3Q20 Earnings Call webcast.

OPERATOR

Good morning and welcome to Tradeweb's third 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 third 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 $0.19. 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 third quarter earnings call.

The world remains an uncertain place amidst numerous political, climate, health and social challenges. At Tradeweb, cyclical macro headwinds from subdued rate volatility and lower yields continue to partially mask encouraging secular and organic growth across our rates, credit and money market asset classes. Our team remains focused on the future, operating purposefully to execute on our growth roadmap by managing what's within our control, which is relentlessly engaging clients, innovating with technology and improving trading workflows to gain share. And as we continue to focus on revenue growth, we believe we are increasing our earnings power, positioning Tradeweb to eventually benefit when volatility resurfaces and secondarily when interest rates head higher. In sum, our message to our investors is unchanged--we remain laser-focused on capitalizing on the secular tailwinds underpinning our business to drive revenue growth and margin expansion for the remainder of 2020, in 2021 and beyond as both our existing and pending investments scale globally.

Turning to slide 4, we reported the strongest third quarter in our history hitting new market share and volume records across a number of products. Specifically, gross revenues of $213 million during 3Q20 were up 5.9% yr/yr on a reported basis and by 4.7% on a constant currency basis. The revenue growth and the resulting scale translated into improved profitability year over year as our third quarter Adjusted EBITDA margin expanded by 91 basis points to 47.4%.

On the investment front, we continued to innovate by rolling out several early stage initiatives. We launched our enhanced specified pools platform after collaborating for a year with leading mortgage originators to design a feature-rich offering to automate this large market which traded $26 billion a day on average during the first nine months of 2020. We believe this offering builds on our strength in the TBA market. The frequent, high-volume and spreadsheet driven nature of the specified pools market makes it well suited for automation as we estimate electronification levels today are less than 5%. Similarly, the culmination of another year long project led to Tradeweb becoming the first offshore platform to offer foreign investors electronic access to the China Interbank Bond Market or CIBM Direct, complementing our existing BondConnect offering. We now give clients access to the two most popular northbound trading channels and nearly doubling our addressable market. Finally, in U.S. corporate credit, we continue to lead the next generation of innovation in the space, building on the growing adoption of net spotting and portfolio trading by rolling out Rematch, which connects our wholesale liquidity to our institutional and retail liquidity pools. Looking ahead, our sales team remains highly engaged and our technology team has a busy pipeline as we look out over the next twelve months.

Turning to slide 5, this quarter was marked by strong credit and market data growth which more than offset flattish performance in other asset classes. Specifically, credit grew by double digits at 26.9% while rates and money markets were relatively in-line with last year as organic growth more than offset strong rate headwinds. Our post March performance in rates continued to be earmarked by the same mix of tailwinds and headwinds we discussed last quarter. Cash rates posted its second highest revenue and volume quarter as record central bank issuance fueled institutional government bond trading and low interest rates sparked higher refinancing activity, thereby boosting mortgage trading. On the other hand, subdued rate volatility took its toll on most of the rates franchise with interest rate swaps seeing the most pressure. Equities fell 3.9% against an exceptional 3Q19 comparison and market data grew by 10.0%.

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—a tough macro environment characterized by low volatility continued to pressure our volumes which fell 36% yr/yr but outpaced industry volumes as measured by Clarus. Our main focus area and higher fee per million longer duration swaps held up relatively better falling only 17%. All in, our market share hit a new record eclipsing 10% for the first time as we continue to focus on what we can control--deepening our client wallet share and scaling new products and protocols as we unlock new electronic options for clients. We believe we gained meaningful share versus our closest competitor Bloomberg in both the U.S. and Europe. 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 U.S. Treasuries— our volumes increased 6% yr/yr led by the institutional business pushing market share to record levels exceeding 15% of the U.S. Treasury market. Amidst a backdrop of heavy stimulus driven issuance, the composition of the UST market has shifted towards the institutional sector as client activity surged while wholesale activity slowed. At Tradeweb, share gains within institutional, 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 adoption of our early-stage protocols such as STAQ, Tradeweb+ and RFM. In the wholesale arena, our disclosed streaming protocol registered its second-best quarter as trading behavior continues to shift away from traditional central limit order books given better price discovery and reduced information leakage and as clients respond positively to our proprietary technology investments relative to the competition. Looking ahead, we believe the mix of our organic 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 emerge from this pandemic into a higher and more volatile interest rate environment.

Shifting to Credit, the asset class continued its strong growth, and generated $50 million in revenues. Our U.S. corporate credit market share continues to rise and set new records in both investment grade and high yield driven primarily by our institutional RFQ business, recent innovations like portfolio trading and net spotting and growth of our suite of anonymous trading protocols. Our wholesale session trading business rebounded back to levels seen in 1Q with activity accelerating in September. The retail business saw significantly less activity as low yields reduced the appeal of credit products for financial advisors. Looking ahead, we continue to see a lot of opportunity in credit as our platform continues to scale. We remain focused on serving both voice and electronic workflows and electronically connecting our three pools of liquidity.

Finally, within equities, institutional ETFs were down 8% yr/yr as volumes were hampered by subdued European market activity especially in August which displayed a typical summer lull relative to the heightened volatility that characterized August 2019 when recession and trade-war fears gripped the market. Fundamentally, we continued to add new clients globally and remain excited about the prospects for the business. Our progress was recognized when our ETF platform was recently named as the best ETF platform by ETF Express US Awards. We believe our intelligent pre-trade liquidity provider selection, robust electronic audit trails, and deep integration with OMS providers continue to drive the success of our offering. Our other initiatives to expand beyond our flagship ETF franchise are also bearing fruit with momentum continuing in equity options, Delta1 and convertibles. During the quarter, we also announced a partnership with CBOE for EFPs which will leverage our leading wholesale ETF platform, a primary destination for EFP trading. Looking ahead, we believe we remain well-positioned to benefit from the continued growth of ETFs globally, with our newer product additions and an expanding client footprint.

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. Swaps remains a critical component of the Tradeweb story and one with considerable room for growth and innovation. We continue to operate with a growth mentality investing for the future.

The broader industry backdrop in 3Q for interest rate swaps remained cyclically challenging given low interest rate volatility. Industry volumes as measured by Clarus were down 38% yr/yr during the quarter driven primarily by a 56% decline in lower fee per million overnight index swaps (OIS) which were pressured by reduced speculation on the front end of the curve. The higher fee per million core IRS market fared relatively better—industry volumes here declined 29% year over year.

But as Lee indicated, our volumes outperformed the overall market as our targeted investments continue to pay off. Specifically, our market share increased to a record 10.2% from 9.8% last year driven primarily by gains within core IRS, our main market of focus, where share rose to a record 17.5%. We were also pleased to be recognized by Global Capital as the OTC Trading Venue of the Year for our consistent ability to pioneer the next generation of tools to access liquidity and inform trading decisions.

We are continuing 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. We are launching new protocols like RFM, adding new products like electronic FRAs and packaged swaps and expanding regionally in APAC.

Specifically:

- During 3Q, we posted our highest single revenue day for EM swaps 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 $386 billion over the last twelve months. During 3Q we added three new currencies bringing our total to 13 and completed our first Chinese IRS trade. The momentum is building and today we have more than 40 clients and 15 dealers, both numbers doubling since 3Q19. Looking ahead, we continue to add more currencies and actively onboard dealers to provide liquidity for specific currencies.
- Clients are also utilizing list trading to trade risk, migrate positions from LIBOR to new risk-free indices like SONIA and SOFR, and switch portfolios between CCPs in anticipation of Brexit. Like we have always done, we are partnering very closely with our clients to help them navigate regulatory change.
- We also are continuing to grow our electronic solutions for historically voice traded products such as swaptions and multi asset packaged swaps. Clients have now traded $74 billon in multi asset packaged swaps since our launch in August last year. Given the momentum, we intend to add more currencies as we build this offering out.
- Our efforts to build a competitive wholesale FRA offering continue and the early signs are encouraging. We traded nearly $18 billion daily, a new record during the third quarter.
- Protocol wise, we are growing RFM or Request for Market which helps clients protect their intent to buy or sell by requesting two-sided markets. We continue to onboard dealers to support this market.

In sum, with global electronification levels in swaps hovering around 20-25%, we continue to strategically collaborate with our clients to migrate more business online. Real change is rarely instantaneous, but rather a series of day-to-day evolutions that combine to drive behavioral change. We are focused on listening to our clients across all our products to create win-win outcomes for them and Tradeweb.

U.S. Credit

One product where we have had several win-win light bulb moments is U.S. corporate credit on slide 8. We continue to invest to build a franchise that supports both electronic and voice workflows by leveraging our unique and diverse liquidity pool shared across our wholesale, retail and institutional sectors. Our value proposition is resonating strongly with our clients as our network continues to grow with more than 720 clients signed up to trade on Tradeweb at the end of 3Q. As a result, market share and block share continue to increase across both our IG and HY offering as our liquidity pool deepens.

In terms of drivers, the composition of our share continues to be led by our institutional franchise which helped drive TRACE HY market share to a monthly record of 5.3% in September and HG market share to a record 18.2% in August. Clients continue to increase their engagement with our pioneering innovations like portfolio trading and net spotting and are also ramping up their disclosed and all-to-all RFQ activity on the platform. Portfolio trading continues to see increased adoption as clients across a variety of financial institutions champion the protocol's efficient price discovery, faster risk transfer, greater certainty of execution and reduced information leakage. Specifically, we estimate portfolio trading has increased to comprise approximately 3.0-3.5% of TRACE from about 2% at the end of 2019 and Tradeweb accounted for $28 billion single and multi-dealer portfolio trades in the third quarter alone. Behaviorally, as comfort with the protocol grows, clients are increasingly putting dealers in competition and increasing the size and complexity of their trades. As a result, the number of line items in portfolios on our platform also hit a new record.

Our advanced net spotting offering saw another healthy quarter with $73 billion of activity and over $225B year-to-date as clients increasingly co-mingle electronic and voice trades to maximize savings and eliminate the inefficiencies of manual processes. We estimate we saved clients over $50 per million during the third quarter.

We also continue to invest in creating the broadest anonymous trading offering in the market. Trading volume here rose to over $50 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. We were also pleased to be included as an all-to-all counterparty for the New York Fed's Secondary Market Corporate Credit Facility, building on our existing relationship for disclosed trading.

As Lee mentioned, we are very focused on connecting our three pools of liquidity—to this end, our effort to incorporate retail streaming order book liquidity into institutional RFQ trading continues to see increased adoption, and we recently launched our ReMatch protocol which will enable unmatched wholesale inquiries to interact with all the liquidity on Tradeweb. We are very focused on leveraging our technology and sector-wide presence to optimize price discovery and maximize matches by connecting inquiries across sectors and we believe we are in the early innings of this story.

We are also heavily investing in expanding our leading automated trading capability AiEX within credit. We recently rolled out an enhanced offering, giving traders more control over the degree of automation and we saw record levels of activity in September. We also continue to invest in increasing the coverage of Ai-Price, our evaluated pricing offering in credit, which today prices more than 20,000 bonds.

Turning to the rest of our credit business, we believe one of our strategic advantages lies in the diversity and liquidity of our product set. As such, we were pleased to offer our insight on the corporate and municipal bond market at the SEC's Fixed Income Market Structure Advisory Committee Meeting. Our Credit Default Swap business, posted its strongest third quarter to date as we continued to gain more market share in both the U.S. and Europe, and our China Bond volumes hit a new record. Municipal activity declined year over year driven by reduced buying in the retail sector. However, our effort to build an institutional offering continues with double-digit ADV growth putting us on course for a record year.

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 execution traders across the market with a variety of protocols to intelligently find liquidity and optimize their execution objectives.

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.

We reported quarterly total ADV of $780 billion, down 4.5% but up 5.4% when you exclude short tenor swaps. Areas of notable growth include mortgages, U.S. corporate credit, global CDS, Chinese bonds, equity derivatives and bilateral repo.

Slide 10 provides a summary of our quarterly earnings performance.

- Despite the lower volumes which were mainly driven by short tenor swaps, 3Q volumes translated into gross revenues increasing by 5.9% on a reported and 4.7% on a constant currency basis. We derived ~36% 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 7.1% and our total trading revenue increased by 5.5%.
- Total fixed revenues related to our 4 major asset classes continued to grow as expected, up 3% yr/yr and 1% 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. Rates fixed revenues growth was driven by the addition of new dealers in swaps and the impact of FX.
- Market data increased by 10% yr/yr led by Refinitiv, APA and proprietary data products.
- Adjusted EBITDA margin came in at 47.4%, and expanded nicely by 91 basis points relative to 3Q19 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 12% yr/yr; primarily as the result of mix shift away from lower FPM short tenor swaps and towards higher FPM HG/HY credit; Excluding lower fees per million short tenor swaps and futures, our blended fees per million was up 1% 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 14% yr/yr overall.
    - For cash rates products, which include government bonds and TBAs, fees per million decreased 6% primarily due to a mix shift to mortgages, which carries a lower FPM than the cash rates average.
    - For long tenor swaps, fees per million was up 12% yr/yr due to an increase in average maturity and less compression activity.

- In other rates derivatives, which includes rates futures and short tenor swaps, average fees per million increased substantially yr/yr due to growth in FRAs which carry higher fees per million than overnight index swaps.
- Continuing to credit
  - Average fees per million for credit increased 13% yr/yr overall.
  - Drilling down on Cash Credit, average fees per million increased 9% due to a positive mix shift towards U.S. HG and HY activity, which carry higher fees per million than the cash credit average.
  - Looking at the Credit Derivatives and electronically processed US Cash Credit category, FPM decreased 4% on higher electronically processed HY volumes and more roll activity in CDS.
- Continuing with equities
  - Average fees per million for equities was down 23% yr/yr overall.
  - For cash equities, average fees per million decreased 27% due to mix shift towards wholesale ETFs which carry lower fees per million than institutional ETFs.
  - Equity derivatives average fees per million increased 2% due to regional mix shift towards U.S. options which carry higher fees per million than the equity derivatives average.
- Finally within money markets
  - Fees per million decreased 17%.
  - This was primarily driven by mix shift away from high FPM retail CDs given the low interest rate environment and towards bilateral repo, which reached record levels and 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 3Q increased 4.2%. Recall ~15% of our expense base is denominated in currencies other than dollars, predominantly in Sterling.
- 3Q20 operating expenses were higher as compared to 3Q19 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 increased 1.2% on a reported basis and increased 1.4% on a constant currency basis.
- Specifically, general and administrative declined primarily due to less travel and entertainment expense. We continue to expect $7-8 million in expense during the fourth quarter. Longer-term, we are reviewing our level of spend.
- 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 which we expect to continue to ramp going forward.

Slide 13 details capital management and our guidance

- First, on our cash position and dividend policy

  - We ended 3Q in a strong position, holding $677 million in cash and cash equivalents and free cash flow reached $380 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 $10.2 million, a decrease of 16% 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.
- Turning to other guidance items for 2020
  - We now expect adjusted expenses to trend in the lower half of our previous $495 to $505 million range for 2020.
  - We continue to believe we can drive operating margin expansion compared to 2019 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, 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. In sum, despite macro challenges, market share gains and volume increases continue to drive growth today and we believe increase our future earnings potential. The secular trends powering electronification and automation remain intact. 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 across asset classes. The regional, product and asset class diversity of our revenues was on display with another strong quarter for credit with rates, equities and money markets having multiple growth levers despite the noted macro challenges. In addition to organic growth, we continue to spend a lot of time evaluating potential M&A opportunities that we believe would further augment our growth as cash builds on our balance sheet.

With a couple of important month-end trading days left in October, firm-wide volumes are up double digits relative to October 2019. We are happy to provide more detail during Q&A.

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 third 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

Ashley Serrao, CMA, CFA
Head of U.S. Corporate Development
& Investor Relations
Tel: 646-430-6027
Email: ashley.serrao@tradeweb.com

Sameer Murukutla, CFA
Director, Investor Relations
Tel: 646-767-4864
Email: sameer.murukutla@tradeweb.com