

Discussion with Piper Sandler Call

March 11, 2020

Discussion with Doug Cifu, CEO of Virtu and Rich Repetto, Analyst at Sandler O'Neill

Operator

Thank you for standing by and welcome to the Virtu FIA Call. At this time, all participants are in a listen-only mode. (Operator Instructions)

I would now like to hand the conference over to your Speaker today, Mr. Richard Repetto. Sir, please go ahead.

Richard Repetto, Analyst

Yeah. Thank you, Ren. First welcome to everybody and thank you for calling in for the Virtu FIA call. This is our eighth call of our Virtual FIA Conference and we want to thank Doug Cifu, the CEO of Virtu like the other CEO for his commitment to business continuity and trying to get some business normalcy in this turbulent market. So, just some ground rules. You know, we still have a lot of people dial in, we apologize for that. But when we'll take questions, if you want to submit a question you can do it to me and the email is richard.repetto@psc.com. So that in -- we'll see time permitting whether we'll take questions at the end.

So, I will first turn it over to Doug Cifu, the CEO of Virtu for some introductory comments on the market environment and what's he seeing at Virtu. So, Doug?

Douglas Cifu, Chief Executive Officer

Great, thank you and good afternoon, everybody. Rich, thank you for setting this up and for inviting us. And as Rich said, I thank everybody for joining. I know folks are busy and distracted dealing with the environment both in the financial markets and in the greater environment. Just some brief introductory comments about what we are seeing here at Virtu and how the firm is handling it. And then I will turn it back to Rich for questions and I will do my best to try to answer everybody's question.

So, it is -- it goes without saying that the marketplaces that we have seen globally and again we're a market maker and institutional broker in over 50 countries, in 235 markets. So, we see a lot of flows and these are unprecedented times. You have a confluence of obviously reaction to the virus, a disruption in the crude and in the energy market and then various interventions by central banks, including the Fed and today, the Bank of England and so it is a confluence of all of these events, that has led to extremely high elevated levels of volatility and volumes across all the asset classes and geographies in which we make markets.

This is truly a global phenomenon that is unprecedented certainly in the 12 years that we have been running Virtu Financial, there have been a number of instances of episodic volatility that we have dealt with in the last 10 to 12 years, all of which either impacted a single asset class or geography and lasted a day or two or three or a week in some instances, but we've not seen anything that is this pervasive in this global in nature.

The firm's reaction to this is obviously been to first and foremost be cognizant of the risks and try to manage all of the various flows that we are receiving. And we have spent a lot of years and a lot of money having a financial technology system that is able to handle and process significant amounts of order flow and I'm happy to report we have done that very, very successfully.

But secondly, and most important, our job is first and foremost to provide great customer service to our clients, both on the market making side and on the institutional side. We have literally thousands of clients around the globe that are trying to understand and deal with what is going on in the marketplace and so they are seeking our advice, our liquidity and our execution services and all of our 1,000 employees around the world are striving very hard to continue to provide that service. I'm sure you will have a lot of questions about what we are seeing in the US equities market, but Virtu is a lot more than that and so we're seeing elevated flows and elevated questions and a lot more interest in our global equities business and what we do in FX, fixed income, options and ETF market making around the world, and as well, all of our financial technology products.

So the markets have functioned exceedingly well particularly the equities markets. We've had very minor slowdowns and a couple of outages, it was one up in Canada. There were a couple of dark pools that slowed down, but other than that there has not been any systemic slowdowns or breakdowns of the exchanges. And so I highly recommend the investments that the exchanges globally, we have made in their infrastructure around the world. That is a significant improvement that we've seen in the last four or five years.

As well as everybody knows we had first market wide trading halt here in the United States, just this week and again a lot of thought and care was put into that by the exchanges and the regulators and a lot of other market participants and while there are certainly things that we have learned that we think we can improve from that and there is already a committee information to discuss improvements that we think can be made to that. I thought the industry as a whole and the exchanges in particular handled that very, very well.

And I think it is very important for all of the market participants in this time of -- I'll say crisis, for all of us to be aware and to continue to allow the capital markets to function efficiently as they have for years. And so we play a very meaningful part of that. We continue to play a very meaningful part of that. I'm very proud, by the way that we have conducted ourselves. We're obviously trying to manage the risks in the flows, back and forth. We have put out our numbers for the first and second quarters. I'm not today going to discuss our results for March, that's not the purpose of this call. But certainly, these elevated volumes and volatilities are very attractive for a market maker and for an institutional broker, but it's much more important that we talk about our role and the significance that we play in the financial ecosystem.

So, Rich, those are sort of my overviews. I'm happy to take specific questions that you have.

Richard Repetto, Analyst

Yeah. Thanks, Doug. That's -- you actually answered a couple of -- the first few questions that I had. So if we sort of took this sort of systematically -- if you look at market making, you have put out the results for January and February and we can read the volatility every day, the volumes every day, but I guess the point that I want to draw out is you made it -- you highlighted that volatility was up across asset classes globally and that's something that Virtu, since I covered since the IPO, but has stressed about the number of exchanges, the number of countries you're in, the number of products you're in. So can you talk about the sort of the match-up of your market making diversified capabilities and this -- what you call widespread volatility across the globe that you've already talked about?

Douglas Cifu, Chief Executive Officer

Sure, sure. So the phenomenon we are seeing in US equities where we have virtually unprecedented days, I think we had a 19 billion share day last week and we've seen the VIX spike up to over 50. We are seeing similar results or figures, if you will, across the board. So the Japanese market, the Japanese equities in the futures markets have seen unprecedented volumes and volatility. Australia has been very busy.

EU notional turnover, I think on an earnings call maybe last quarter or the quarter before I said we were used to seeing 40 billion share days notional price, we were not even getting 30 billion share days and I said anything more than that was a white rhino was the comment I made. Well we're seeing a lot of white rhinos. We have had EUR60 billion and EUR70 billion notional turnover days across the EU. We've seen increased volumes in Canada and US equities.

But also in the FX market, which had reached historical low volatility levels in the fourth quarter of 2019 and so you've seen a tremendous spike in volumes and volatility across the FX market. And then lastly, obviously in the crude and in the energy complex, the actions I guess I'll call them by OPEC over the weekend with the largest one-day decline in the price of crude oil, I think Rich, since even the first Persian Gulf War way back before we even had electronic trading.

So you are seeing unprecedented levels of volatility and volume, but -- and they are not episodic. They continued now for these 10 or so trading days.

And again, I'm not a prognosticator of the marketplace. That's not what we do at Virtu, but I'm a guy that watches TV and reads the paper like everybody else, it does not appear as if this is going to dissipate any time soon. So we are hunkered down here at Virtu trying to serve our clients, trying to give great two-sided prices, trying to execute efficiently, making sure that our EMS solution, where we got 1,000 customers accessing the market is up and vibrant and running 24 hours a day, five

days a week, that's what we're focused on, and I think that's really our role in the financial ecosystem.

Richard Repetto, Analyst

And I think you mentioned the things I want to get at, Doug, is if you take FX and we know your market make is there. The VIX has doubled or nearly doubled over the past week and energy that goes back to your roots and I think everybody is aware of the volatility there. So I guess the only question -- there is interest rates, there is some of the newer products that are becoming more electronic, like interest rates credit, et cetera. You know -- is it say -- would they fall in the same category of -- it certainly by looking at Treasury prices, you'd expect high volatility across the board to be benefited in there as well?

Douglas Cifu, Chief Executive Officer

Yeah, I mean there were unprecedented moves where you have the entire yield curve below 100 basis points, right. I mean that's something I never thought I would see. One of the things we checked in our system was to make sure if interest rates went negative right, would we be able to continue to trade in price. Again, these are the types of things that were not really within contemplation, right. So you've seen increased activity there and obviously in the options market as well. I mean we're not large participants. We're kind of baby participants all those marketplaces, and so we've seen increased volumes and volatility there. Our bread and butter global equities and across the FICC complex to your point, Rich, we have seen very significant elevated volumes and volatility.

Again these marketplaces for the most part have functioned exceedingly well. And so I give a lot of credit to the regulators and to the global exchanges that have invested in the ecosystem and responded to criticism in prior years in 2015 and another events where we have strengthened the ecosystem.

Richard Repetto, Analyst

Got it. And then I guess one last question on market making. The volatility, at least in the past has been some volatility if it's just one way that probably isn't as good for a market maker, would you say -- could you sort of comment on the -- it seems like many of up and down movements here and we have got some movement. So just talk about, sort of, I mean -- the volatility, we're seeing?

Douglas Cifu, Chief Executive Officer

Yeah, I mean there is this mythology out there that somehow in our wholesale-retail business that you just kind of clip coupons, right, and nothing could be further from the truth because we are providing meaningful price improvement. When this is all said and done, we will go through the statistics as to the aggregate notional amount of price improvement we're providing retail investors. I don't have that number today, it's going to be extraordinarily large, given just the magnitude of market orders that we have processed here at Virtu and what my colleagues at Citadel another great firms have done as well, we provided 10s of -- hundreds of millions of dollars of price improvement in the last two weeks.

And so, yeah, there are moments in time when the market is kind of falling off a cliff, and there is a significant imbalance to retail orders that it's really difficult to be a market maker, you're catching, we can't turn off and we don't turn off in those circumstances. We have agreements with the 200 retail brokers that send us flow that we will continue to price that well. We will continue to provide price improvement to it. We don't just exhaust it out to the exchanges. Obviously, we do some of that.

And so we're catching a lot of falling knives during that time period and that's the Yin and the Yang of being a market maker. You're right, Rich, there are also times where there has been reversion and up and down and whatnot. And so that's a little more -- that's an easier environment to be a market maker. On balance, when there is elevated volumes and volatility, the bid-offer spread is wider and X volume Y bid offer spread equal Z and so generally in these marketplaces the X and Y's are significantly larger than they would be in a quote-unquote normal market environment certainly of the type we saw in 2019.

One other thing, some of our new initiatives, our outsourced trading desk has seen a significant uptick in activity again because the buy side is busy, right. And there is a lot of overflow trading and so we've seen a big uptick there, so I'm glad we started that initiative and as well Virtu Capital Markets, which is our -- the initiative we started in the second half of 2019 has seen some significant interest from issuers that when the market was up needed to get liquidity or sometimes now when the market is down, they need to get liquidity, so they're using us because of our efficiency and scale in terms of routing orders. So it's -- we've seen some nice upticks in those initiatives that we started in the second half of 2019.

Richard Repetto, Analyst

Got it. Again I just want to remind everyone if you do have a question feel free to email it to me at richard.repetto@psc.com. But you hit on a point Doug, melting these or integrating these new businesses into the legacy Virtu with KCG, but much more broader with ITG as well and their products, and I guess could you give us a little color on how the Execution Services side of the business is doing as well?

Douglas Cifu, Chief Executive Officer

Yeah. Yes, sure. So we had closed the ITG transaction about a year ago and so we had done a significant migration of former ITG clients in the United States and in Europe and we have started the migration of clients in Canada and in Asia on to the Virtu Algo stack - and so that has -- was fortuitous in that those algos, we believe are highly performance. They scale very well and the throughput is very, very robust.

And so the timing was propitious I guess if you will, for the transaction in that we were ready willing and able particularly in the United States and Europe for an influx of algo flow. So that desk has been extremely busy in the last couple of weeks and the feedback again from clients and customers has been very positive.

On the broker neutral side we had in the United States and in Europe in particular we had done significant technology work in terms of re-platforming our POSIT Alert block crossing network. And so we have seen significant increase in the usage of that and broker neutral product in all three of our regions, actually all four in the United States, Canada, Europe and in Asia.

And so we're very happy that we had made those investments that the POSIT Alert product is more robust, has lower latency and better throughput, right. All of those things are very important in terms of functionality in marketplaces like this because there is nothing that's going to irritate a buy-side clients more than if you get frozen are a slow GUI or it doesn't get our response time or an acknowledgment from an order and so having performance systems is really, really important.

And then I mentioned before, but I'll mention again the comments I just made, we have a market leading execution management system called Triton that sits on the desktop of buy side and sell side customers around the world. We had just launched in the last three to six months a new version called Triton Valor. we had rolled it out to a lot of clients and again performance there is just really important because it's sitting on a lot of early important desks of our clients around the world and they want to make sure when they're pushing their buttons and clicking their GUI that they get their acknowledgments in their fills.

Here it can mean a lot of money one way or the other because these markets are really, really moving very, very quickly. So we've made a lot of investments already. Obviously, there are things in hindsight you wish you would have done more or done faster or done this and we're continuing to upgrade, but the timing of the ITG transaction and our ability to kind of rapidly integrate that to the firm has paid handsome dividends during this period. And I think it will continue to ensure to our benefit as long as obviously this lasts, but more importantly, we've got the goodwill of clients that are using these products in times of frankly crisis and borderline pandemonium.

Richard Repetto, Analyst

Got it. I have had some questions come in and I'll just go. I'm just ask it directly. It says with the very strong cash flow we suspect you're experiencing -- are you going to -- what do you can do to generate -- what are going to do with this cash flow? Do you plan to delever?

Douglas Cifu, Chief Executive Officer

Sure. We've always said that our target was 2 times to 2.5 times debt to EBITDA ratio I don't know what our ratio is right now. It's getting better obviously, as we generate more cash and so right now we're not focused on deleveraging this week or next week or the week after, we're really focused on, continue to provide great client service, but we have always been really good stewards of capital in terms of one, borrowing and then deleveraging; two, buying back stock, when we find it attractive; and then three, providing a very consistent dividend to our investors even from one before we went public. So we'll continue that policy going forward.

Obviously, when our results come out for the first quarter, you will see over the long period of time, we've more than covered the dividend, I've always said that and so there is a significant cushion around that. And so Virtu continues to be a firm that is

very, very -- that takes its obligations with respect to returning capital to its investors very seriously.

Richard Repetto, Analyst

Got it. Another question, as buy side investors what metrics should we be monitoring closely to make sure Virtu and Citadel and the banks are functioning properly?

Douglas Cifu, Chief Executive Officer

Yeah.

Richard Repetto, Analyst

We're not talking just volume and volatility --

Douglas Cifu, Chief Executive Officer

Yeah, no that's a great question. I mean, obviously we are functioning properly and I'm saying that Citadel is a world-class great firm run by a terrific leader and they're extremely well organized and have invested probably billions of dollars in technology and my friends at the banks are in a similar situation.

So to the extent Virtu or one of the other participants was out of the marketplace, it would probably resonate pretty quickly, right, because we're all major participants in the marketplace, particularly in US equities. It's a small world and so I would imagine that there probably be some notification of that I would find that would be pretty unusual.

The market would survive. There's a lot of different participants, right. We have competitors and all of our retail partners, none of them sole source to Virtu, nor should they. They use Virtu, they use Citadel, they use Susquehanna, they use Two Sigma, UBS, right. There's a lot of great firms that do what we do on the kind of 605 wholesaling business. So there's a lot of resiliency and redundancy built into the system. Obviously, I run this firm and I'm very proud of how we have always acted in conducted ourselves and the competitors' firms that I just mentioned, all of whom have continue to operate in this environment.

Richard Repetto, Analyst

Got it. Another question. It says: can Doug comment on progress they are making in new products and asset classes. What is the outlook for adjusted net trading income growth in new non-Americas Equities products?

Douglas Cifu, Chief Executive Officer

Okay. So just make sure I understand the question. So new non-Americas Equities -- so I guess what the question is referring to is our ETF business outside the United States. I mean we continue to invest there, we are quoting block ETFs in Europe. It's been a good time to be doing that. We are the new comer there, right, so our volumes have not been large, but certainly the P&L opportunity in an environment like this is very significant, so we are doing that in Europe and in Asia.

Similar to our options market making here in the United States, where again, we're not talking about, we're not going to disclose individual numbers, but it has been a nice environment even to have a small, but growing business, because there's a lot of opportunity there and we have the platform and the scale and the systems and everything has been in place. Same with corporate credit market making, which again is a US activity and I think those are kind of the main things that we have focused on outside of US equities and that we have talked about. So all of those continue to scale and growth remains a priority of ours and obviously in this environment, it's going to do -- it's hard to separate, sometimes the alpha from the beta, right, but there certainly is alpha and beta in this marketplace.

Richard Repetto, Analyst

Understood. Just my question. So on the market making you've experienced a number of quarters with volatility -- significant volatility, whether it be the Swiss franc decoupling or other end of 2018. So again you noted, if this is significantly maybe extended here this quarter, but you've gone through that and we can see how the company performs. I guess when looking at the market maker performance, looking at execution services, you know what

have you learned or jumped out, I think this would be your first highly volatile period with being the owner of ITG and services, the dark pools, so can you comment on anything takeaways you've learned generically I come through or not quantitatively, but reactively about?

Douglas Cifu, Chief Executive Officer

Yeah, that's a great question, what I've learned is ITG really had and continues to have an incredible franchise. I mean, we have an unbelievable assortment of clients that have continued to use us and frankly are using us more during this crisis, because they really are looking to us to understand kind of what's going on, how to get executed. They want either immediacy or transparency and they know that we are a firm that has robust, transparent electronic execution, and we have a unique global view of kind of what's going on, both in Japan as well as Austria as well as Chicago across asset classes and geographies, right.

So, and it is literally a potpourri of clients from large government pension funds to multinational asset managers to long-short funds to quant firms and everybody in between of all sizes and shapes and as well on our ETF desk, we have people -- it's always been a bit of a kind of trading and consulting business over there, if you will, because we're helping clients understand how they can manage their risk and balance their portfolios. And so we have a lot of capacity to service those folks. Virtu has 1,000 great employees roughly in it right now and a vast preponderance of them are client facing. So it's not a firm of robots, if you will, that kind of stuff. So we have a broad portfolio of products and services. And then the last thing which I should mention, which I've neglected to mention is our analytics business right. This is a time when asset managers, our customers and our clients and analytics really are leaning for us in terms of bespoke -- bespoke review and analysis of their performance and how they should get in and out of positions.

The last thing I'll say is and I won't comment on any specifics, but we have been in touch with regulators in this country and abroad, because we are a large market participant. They have asked us questions around the functioning of the markets. They have asked us questions around, obviously, the market wise circuit breaker, end market structure and they want our input and they want to understand how the market is functioning and could we do better. There have been multiple calls that I have received myself from very senior folks around the world that are looking to Virtu for experienced leadership, thoughts, conditions and we offer those opinions and try to be as collaborative as we can because it is fully in our best interest to have the market function in an open, transparent and efficient way.

Richard Repetto, Analyst

Got it. I'll ask one last industry question that keeps sort of popping up. So you've had some big mergers, Morgan Stanley, E-Trade, Schwab, Ameritrade affecting the retail market. So there's been a lot of -- some questions about payment for the flow. Could you comment on -- do you expect any significant changes that these mergers impact, what you're willing to pay or what you would pay et cetera in that area of payment for order flow as a wholesale market pick?

Douglas Cifu, Chief Executive Officer

Sure. Sure, it's a good question and I have been pretty direct in terms of answering it. All of the retail brokers we deal with are routing orders to us based on execution quality or price improvement. There are brokers. So it's always EQ, EQ, EQ.

We are competing with Citadel, Susquehanna, Two Sigma, everyday, every week, every month, every quarter on execution quality. How much are we improving the national-best bidder best offer even in these volatile times, okay.

There are brokers, some of which you have mentioned retail brokers that do take payment for order flow, at varying amounts. It's all publicly disclosed. I'm not going to go through their 605 reports, okay. So Schwab and TD Ameritrade are both in that camp. They take different amounts and our market share with Schwab as I said on a prior call is larger than TD Ameritrade. I have every reason to believe we will continue to have significant market share and again we are agnostic. It's not our job to ascertain whether a broker wants 100% EQ or price improvement or some mixture of a rebate or execution quality.

What we have said and what we will continue to say is, there is a certain amount that we are prepared to offer because there's only so much that we can do in a profitable fashion depending upon market conditions and market share in all those types of things and it is not our job or our business to decide in what format that is returned to the brokers. So again, I have no concern. I know, I've heard some of the stories out there that somehow there is going to be bargaining power and we're going to be in this payment for order flow race. That used to be the case, I guess 10 years ago. The retail brokers don't operate in

that fashion anymore. They are very cognizant of their responsibilities. The four names that you mentioned are all world-class organizations with world-class people that have provided unbelievable customer service and are very cognizant of the regulatory obligations.

So I have very little concern that somehow this price war is going to breakout. I understand bargaining power. I understand mergers and acquisitions very, very well. We are key service providers to these clients and they want sustainable long-term relationships with us. We're their market centers. Nothing highlights the importance of Virtu Financial, Citadel, Susquehanna, Two Sigma, UBS, the five of us then this environment.

They are literally routing to us every single day, billions and billions of dollars of risk and we are managing it and we're providing them great execution quality. That's not about payment, that's about service. That's what this firm and the four firms that we compete with all do an awesome job. So will the market shares ebb and flow? Absolutely. Because this situation highlights the importance market centers like Virtu and the other four firms. Absolutely, they want a sustainable ecosystem that provides enhanced value to retail clients, at an efficient and attractive rate and that's what we provide and will continue to provide.

Richard Repetto, Analyst

Okay. I don't have any more questions coming in to me and I think you sort of described in the best way you can intra-quarter, sort of what's going on. I'd also -- first I want to thank you for keeping the commitment of the meeting with investors and doing it virtually and then I would say, I think you did a good job explaining that Virtu is one of the unique companies that benefits in turbulent times and you've done a good job at humbly sort of making your case here and explaining it. So I want to thank you, Doug. Again, I'm not seeing any more questions. If you have any closing remarks --

Douglas Cifu, Chief Executive Officer

Yeah, I just want to thank you, Rich for putting this together and I was -- I decided to do this, because I had made a commitment to do it. I didn't want at all for this to be a focus on Virtu or it's a results because obviously there are very significant things going out there in the world, which are a hell of a lot more important than my little company and our results. So I wish everybody safety and peace and that we all get through this together.

Richard Repetto, Analyst

Thank you, Doug. Wren that will end the call, so you can close the call. Thank you again.

Douglas Cifu, Chief Executive Officer

All right, thank you everybody.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.