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VIRT - Q1 2015 Virtu Financial Inc Earnings Call

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Douglas Cifu *Virtu Financial - CEO*

Joseph Molluso *Virtu Financial - CFO*

CONFERENCE CALL PARTICIPANTS

Alex Kramm *UBS - Analyst*

Rohit Sahni *Harbor Spring Capital - Analyst*

Roger Miller

PRESENTATION

Operator

Good day, ladies and gentlemen. And welcome to Virtu Financial First Quarter 2015 Earnings Results conference call. At this time, all participants are in listen-only mode. Later, we will conduct a question and answer session, and instructions will be given at that time. (Operator's Instructions).

As a reminder, this conference call is being recorded. This time, I would like to hand the conference over to Mr. Andrew Smith, Head of Investor Relations of Virtu Financial. Sir, you may begin.

Andrew Smith - Virtu Financial - Head of IR

Good morning, everyone. By now, you should see our first quarter results which were released this morning and are available in the investor section of Virtu.com. The release will be archived and this call will be available for replay on Virtu.com.

Today's call may include forward-looking statements which represent Virtu's belief regarding future events and are therefore uncertain and outside the Company's control. Our actual results and financial condition may differ materially from what is indicated in forward-looking statements.

We refer you to disclaimers in our press release, and you should review a description of risk factors contained in our final S-1 registration statement. In addition to GAAP results, we also refer to certain non-GAAP measures including adjusted net trading income, adjusted net income, adjusted EBITDA, and adjusted EBITDA margin.

We believe these non-GAAP measures are more reflective of operations and core business performance. You'll find a reconciliation of the equivalent GAAP term in the earnings materials in an explanation of why we deem this information to be meaningful as well as how management uses these measures. When used on this call, adjusted net trading income refers to our trading income net of all interest and dividend income and expenses and all brokerage clearing and exchange rebates or fees.

Speaking and answering your questions today are Douglas Cifu, our Chief Executive Officer, and Joseph Molluso, our Chief Financial Officer. They will begin with prepared remarks and then take your questions.

I would now like to turn the call over to Douglas.

Douglas Cifu - Virtu Financial - CEO

Thank you very much, Andrew. And good morning, everybody. Thank you very much for joining our first earnings call as a public company.

The first quarter was one of the strongest in Virtu's history. Our adjusted net trading income was \$148.4 million for the quarter which reflected a general environment of increased volumes in volatility across the asset classes and geographies in which we make markets. In particular, volumes and currencies and energies were up significantly versus the prior year, and the overall environment was much more volatile.

These volumes and adjusted net trading income figures translated into strong profitability overall as our adjusted net income and adjusted EBITDA before our pro forma IPO related adjustments was \$87.9 million and \$106.4 million respectively for the quarter.

Virtu was consistently profitable throughout the quarter including during some notable events which contributed to overall volatility and volumes such as the Swiss National Bank related events and the sustained volatility in the US and European equity and global energy markets throughout the quarter. These market events also demonstrate the robustness of our [risk system] as we were able to make markets through these volatile events without incident.

We obviously cannot predict where or when these exogenous events will happen. However, as we discussed on our IPO road show, because of Virtu's scope and scale, Virtu is poised to realize the benefits of increased volumes and volatility in each of the 225 markets in which we participate.

The first quarter of 2015 really demonstrated the benefits of our broadly diversified market-making model. We continue to attempt to improve our operating performance in the asset classes and geographies in which we operate and to identify new markets and new opportunities. As of March 31st, we were connected to 225 unique venues and traded over 11,000 financial instruments in 34 countries globally. During the first quarter of 2015, we improved our operating performance in each of our six reporting categories as we will discuss in detail later on this call.

Key areas of focus for new opportunities remain Asia, including India and China as well as markets that continue to become more electronic and more transparent. As you all know, we successfully priced our initial public offering of Class A common stock of Virtu on April 15th, 2015.

In the IPO, we sold approximately 19 million Class A shares at \$19 per share and used approximately 277 million of net proceeds after the IPO discount and commissions that purchase common units in Virtu LLC from selling shareholders. And we will use the remaining approximately \$59 million of new net proceeds before the IPO expenses for general corporate purposes and working capital.

Also, I'm very pleased to report as we announced earlier this week, the board of directors of Virtu Financial approved the appointment of John Nixon to our board of directors on Monday. John is a talented industry professional who spent the vast majority of his distinguished career at ICAP. And we look forward to benefitting from John, the vast experience and deep relationships to help guide Virtu's long-term strategy.

As you all know, the volume trends we saw on the fourth quarter of 2014 and the first quarter of 2015 has slowed down somewhat in April although the environment remains as or more favorable than what we experienced throughout most of 2014.

Now, I would like to turn the call over to our Chief Financial Officer, Joseph Molluso to go deeper into some of our first quarter results. Joe.

Joseph Molluso - Virtu Financial - CFO

Thanks, Doug. I'll review a summary of our results and point out some financial highlights before we open it up to questions.

So in our S-1 registration statement filed in connection with our IPO, we provided ranges for certain financial measures including net income as well as adjusted EBITDA, adjusted net trading income, and adjusted EBITDA margin. Our first quarter results in all cases were towards the high-end or exceeded these estimated ranges previously provided.

As Doug mentioned, we realized \$148.4 million in adjusted net trading income with no one asset class contributing more than 28% of the overall amount. Just a brief reminder, adjusted net trading income is the amount of revenue we generate from our market-making activities. Or trading income plus interest and dividend income at expense less direct cost associated with those revenues including brokerage exchange and clearing fees.

Our net trading income in the first quarter averaged \$2.433 million per day, a 40.2% increase over the same period last year. In general, the volume and volatility environment was more robust in the first quarter of 2015 as compared to last year.

In our press release, we noted several market benchmarks that served as indicators of performance for our six reported categories. In particular, CME energy volumes increased 31% versus the same period last year. And CME FX volumes increased 19%. America's equities benchmark volumes, US equities, were essentially flat. And TSE volumes were down about 5% while European equity volumes were up over 5%.

In terms of profitability, our GAAP net income, before assuming the impact of the IPO, was \$77.4 million, up 58% from the prior year. Our non-GAAP adjusted net income after adding back the effect of certain charges and stock-based compensation, was \$87.9 million. Our adjusted EBITDA was \$106.4 million. Margins improved overall and our adjusted EBITDA margin was 70.5% in the first quarter of 2015 as compared to 65.4% in the first quarter of 2014.

In order to reflect where our financials might have looked like were we a public company during the first quarter, our earnings release included a pro forma analysis as if our IPO occurred on January 1st, 2015. In addition, we have provided a pro forma normalized adjusted net income per share figure which assumes our entire company is subject to corporate taxes. For the first quarter of 2014, this pro forma adjusted EPS is \$0.42 per share.

Now, we recognize that certain of our research analysts from the underwriting syndicate and our IPO may still be restricted. And I just wanted to point that out. But for those who are able to ask questions, we'd now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator's Instructions). One moment for participants to queue up. Our first question comes from Alex Kramm from UBS. Your line's open. Please go ahead.

Alex Kramm - UBS - Analyst

Well, hey, good morning, everyone. Just hoping to dig deeper into some of these areas. Obviously, you talked a lot about year-over-year comparisons. But if my numbers are correct, in particular on the America's equities, I think sequentially versus the fourth quarter, those results came down a bit. And when I look at the overall market environment I think flattish kind of volume or maybe down slightly, volatility was up.

So maybe you can talk a little bit more about what happened in America's equities. Obviously, strong results, but on the quarter-to-quarter basis. I think some folks might have thought those could have been better.

Douglas Cifu - Virtu Financial - CEO

Great. Thank you, Alex. Thanks for your question. We have not released fourth quarter numbers, so it obviously would be a little bit speculation to talk about what we did in the fourth quarter. I thought if you look at the comparison from the first quarter of 2014 to 2015, I thought we performed very well in the sense that our adjusted net trading income was up 15% relative to the prior year where volumes were essentially flat.

So in a 6.9 billion share per day environment, we improve qualitatively. And a lot of that came from both our single-instrument market-making strategy as well as some increased performance in the EPS area.

So I'm not going to talk about quarter by quarter performance last year. I think the first quarter was a very strong period overall. We continue to be very focused and excited about what we're doing in America's equities and US equities in particular.



And I think fourth quarter volumes were slightly higher, if you will, in the fourth in America's equities and US equities in particular. So maybe you'll react to into a little bit of that. But overall, year by year, we're very happy with the performance in the first quarter.

Alex Kramm - UBS - Analyst

Okay. And then maybe just coming back to your comment at the beginning that you said the environment has softened a little bit from a volume perspective but the trading environment is still pretty good. Maybe you can just flush it out a little bit more. I don't know if you want to go by asset class.

But first of all, when you say the environment is still pretty good, are you talking about a full year perspective, are you talking about relative to the beginning of the year, end of the year? And then maybe highlight some of the asset classes that you would want to highlight in particular.

Douglas Cifu - Virtu Financial - CEO

Yes, I know. That's a great question. Thank you, Alex, as usual.

Yes, I mean, really, what I was referring to are the six categories in which we benchmark ourselves. And so if you look at US equity volumes, April versus the first quarter, they were down 7%. Look at Tokyo stock exchange volumes, they were down 5%. CME energy and FX contracts were down 13% and 11% respectively against the first quarter of 2015. European equities were up slightly at 1%.

So those are obviously significant benchmarks for us, and that's how we've analyzed our business, if you will, on the S-1, and we'll continue to analyze our business -- excuse me.

I think year over year, though -- the point I was trying to make in my remarks is that, year-over-year, the volume environment in April of 2015 is favorable as compared to the volume environment in 2014. And we're going to continue to compare ourselves in a year-over-year basis. So I think there's plenty of opportunity out there.

And the firm continues to perform very well. It's just obviously against a quarter in which you had very significant volumes and very significant volatility. It's going to be difficult to repeat that type of performance.

Alex Kramm - UBS - Analyst

Yes. And so I would just harp on this a little bit more. So when you look at the first quarter, any asset classes you would call out where maybe you would be doing a little bit better than what the volumes are suggesting or anything has changed in any of the categories that you would highlight, just versus the first quarter, so far, in April?

Douglas Cifu - Virtu Financial - CEO

Well, I mean, the obvious example would be FX. I mean, unless some of the governments are going to de-peg their currency in the second quarter, it's going to be difficult to replicate the volumes and volatility that we saw in January, February, and certainly even in March of 2015 in the FX market. And obviously that rippled through our European equities business which had a very, very nice quarter.

And a lot of that was the rippling activity when the Swiss de-pegged. And there was a lot of single instruments in Switzerland had all of a sudden become very volatile, because natural buyers and sellers want to get in and out of the positions of UBS and Movado, and other Swiss companies. That's a great thing for our business because we're there to act as the agent to the risk transference of those positions.



So, certainly, it's going to be difficult to replicate that type of environment, those types of exogenous events that can be very, very beneficial to our business. And as we've repeatedly said, the core strength of this firm is the diversification, and so we're there to capture those periods of episodic volumes and volatility where they may arise.

Now that makes it very difficult for folks like yourself and the great investors we have on the phone, obviously, to prognosticate what the firm is going to look like quarter by quarter. Which is why when we're on the road show and when we've talked to investors, we've made it very clear that we don't sit here and model out exogenous events and moments of volatility and periods where crude goes from \$40, back up to \$60 and \$100 to \$40. Those types of events are very difficult for us to model out.

What we do try to do and continue to benchmark ourselves against are these fixed indications of volumes around the world. And the way I measure the performance of this firm is to say, how did we perform relative to those benchmarks?

If US equities was flat year-over-year and our P&L, if you will, or our adjusted net trading income increased 15%, to me, qualitatively, the earnings of this firm increased from 15 to 40. And that's how I look at the firm, Alex.

Alex Kramm - UBS - Analyst

All right. I'll leave it at that. Thank you very much.

Operator

Thank you. (Operator Instructions).

We do have a question from Rohit Sahni from Harbor Spring. Your line is open, please go ahead.

Rohit Sahni - Harbor Spring Capital - Analyst

Hey. Congrats on a great quarter. Could you guys comment a little bit about what you're seeing in the competitive arena, i.e. any notable changes from your peers or anything notable?

Douglas Cifu - Virtu Financial - CEO

Yes. Rohit, that's a great question. Thank you for that.

I mean, it's obviously very difficult in a fully largely anonymous marketplace for us to really understand what competitors are doing. And obviously there are some great, great firms out there that we compete with in different asset classes, in different geographies.

And we do see, episodically and from time to time, in asset classes and geographies, spreads will tighten up. And we know that our competitors are trying to gain market share in a particular asset class. And so off the top of my head, you've seen a little bit of that in the ETF market, where there has been more competitors, maybe a little bit of that in the FX market.

But again, one of the great strengths of the firm is that we are so broadly diversified and we have scaled this business. And so we've got a fixed cost plan, if you will, in terms of telecommunications and connectivity and market data that scales across 225 markets and 11,000 financial instruments. And so we think that that's our key competitive differentiation.



And do we worry about competitors? Of course, we do. We're not so arrogant not to worry about them. But we know that in the long term, we believe we are the quality low-cost provider of the bid and the offer. And ultimately that's what the consumer, the end user, the natural buyer and seller really wants. And so as long as we stay focused to our [knitting], we think in the long term, we will continue to be a big player in this space.

Rohit Sahni - Harbor Spring Capital - Analyst

Great. That's helpful. I guess I'll add one other question.

Obviously your margins did very well this quarter. I think it's over 70%. If we see adjusted net trading revenue normalize or come down from this quarter, do you have any color or guidance on what to expect on margins? Is it fair to say margins may stabilize to something closer to the mid- to high-60s for the full year? Are you giving much color on how to think about your cost structure?

Douglas Cifu - Virtu Financial - CEO

Yes. It's a great question. I'll ask Joe to respond to that.

Joseph Molluso - Virtu Financial - CFO

Yes. In our IPO road show, we talked a lot about our cost structure. We have really a fixed cost plan as Doug said. Our communications and data processing is mainly a fixed cost that supports all the trading. It should really grow as a fixed cost kind of step function in the low single digits. Compensation as well, our set of comp really is not going to scale on a full-year basis with net revenues as our overhead which will also act like a traditional fixed cost.

So if you're looking at EBITDA margins in the mid-60s, through the cycle, that's probably the right area. And in a quarter where we outperform, you see that tick up to the low-70s. So we're comfortable with you thinking about it in that range.

Rohit Sahni - Harbor Spring Capital - Analyst

Got it. And one other question. I know you guys have talked a bit about China and India being exciting growth areas and areas that you want to spend more time looking at. Could you comment a little bit about your strategic plan there, and what you've been doing from a hiring perspective but also from a build-out perspective as you look to get more into those geographies?

Douglas Cifu - Virtu Financial - CEO

Sure. Another great question. Thank you. And I'm happy to talk about it.

I mean, strategically, obviously, those are marketplaces that are attractive to us because there has been adoption of electrification of markets. And you can see, just by looking at the volumes reported, that there's significant natural interest in particularly commodities products in those marketplaces.

And not surprisingly, China and India, both being enormous economies, natural producers need ways to hedge their exposure, and therefore they've developed very robust and, to a certain extent, electronic marketplaces. So therefore, just in the abstract, that's a very attractive marketplace for Virtu to provide its service.

Now for competitive reasons, I'm not going to get into specifics around structuring. But the most important thing -- I have a background as a lawyer, and as an international lawyer. And the most important thing that we do when we go into a market is to go in the right way.



Number one, let's understand the regulation. Number two, let's become regulated to the extent possible and to the extent practical. And then number three, let's partner with the most impressive and most strategically significant folks in the region.

Now we have a benefit in the sense that Temasek, the Government of Singapore's investment fund, is a very significant long-term investor and a significant long-term partner in Virtu Financial. And so they have made the appropriate introductions to us, particularly in China where we will be partnering with, we think, the best local partner in the region to enter that marketplace.

We haven't done anything yet in terms of trading. We certainly have begun very significant preliminary discussions, negotiations, and structuring of a way for us to get into that marketplace. And I promise you, when we do it, we will do it the right way, and we'll see what the results are.

The beauty of our model, however, is that we don't need to establish an office. We don't need to hire 20, 30, 40 people. The business scale is exceptionally well in new marketplaces, asset classes, and geographies without a significant incremental spend.

Will we need to buy new gear and put into a data center? Absolutely. That's the business model. But will we open up an office with 10, 20, 30 people? Unless regulatorily or from a compliance perspective we need to that, I have zero interest in opening up another Virtu office.

I'm not a great guy in terms of negotiating leases and creating overhead. That's really not what this firm is about. So we will use the existing infrastructure, the existing strategies, the existing business that we have in Singapore to enter into those markets.

Rohit Sahni - Harbor Spring Capital - Analyst

Okay. That's helpful. I have one last question, and that will be the last one. I know you guys gave color at the IPO on the dividend. I think you said above 70% of your net income, anywhere above that. Do you have any other updates on how you're thinking about on the dividend percentage going forward?

Douglas Cifu - Virtu Financial - CEO

No. I mean, we really haven't changed from our S-1, which is we've announced that we anticipated \$0.24 per quarter dividend. And that historically, we have paid out approximately 70% of our adjusted net trading income. Right, Joe?

Joseph Molluso - Virtu Financial - CFO

Our adjusted net income.

Douglas Cifu - Virtu Financial - CEO

Adjusted net income, excuse me. Thanks. That's why Joe is here. Okay, so I screw up a little on the nomenclature.

And we've done that historically over the last three years and it is our intention to continue to do that. We don't see any need to retain significant excess capital on our balance sheet. We've been a very capital-light firm. We've been very good about returning excess capital to our stakeholders historically, and we very much plan to continue that practice as a public company.

Rohit Sahni - Harbor Spring Capital - Analyst

Great. That's helpful. Thanks a lot.



Douglas Cifu - *Virtu Financial - CEO*

Thank you, Rohit.

Operator

Thank you. Our next question comes from [Roger Miller]. Your line is open, please go ahead.

Roger Miller

Yes. Hi. I retract my question. The gentleman before me asked the question I was going to ask on competition. So thank you.

Douglas Cifu - *Virtu Financial - CEO*

Thank you, Roger.

Operator

Thank you. I'm showing no further questions at this time.

(Operator Instructions).

Douglas Cifu - *Virtu Financial - CEO*

Okay, operator.

Well, I want to thank everybody very much for taking the time to listen to us this morning. Obviously, we recognize that a lot of our lead analysts at our syndicate banks were restricted from asking questions. So I'm sure we'll have a robust call next time.

And we thank you very much for your continued support of Virtu Financial. And we look forward to talking to you some time in early August. Thanks very much.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This concludes our program. You may all disconnect, and have a wonderful day.



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