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VIRT - Q3 2015 Virtu Financial Inc Earnings Call

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CORPORATE PARTICIPANTS

Andrew Smith *Virtu Financial - IR*

Douglas Cifu *Virtu Financial - CEO*

Joseph Molluso *Virtu Financial - CFO*

CONFERENCE CALL PARTICIPANTS

Richard Repetto *Sandler O'Neill - Analyst*

Alex Kramm *UBS - Analyst*

Ken Worthington *JP Morgan - Analyst*

Alexander Blostein *Goldman Sachs - Analyst*

Christopher Allen *Evercore - Analyst*

Jack Huller *Citigroup - Analyst*

Ashley Serrao *Credit Suisse - Analyst*

PRESENTATION

Operator

Good day, ladies and gentlemen. And welcome to Virtu Financial Conference Call announcing 2015 Third Quarter Results. (Operator Instructions)

I would now like to introduce your host for today's conference, Mr. Andrew Smith, Head of Investor Relations. Sir, you may begin.

Andrew Smith - *Virtu Financial - IR*

Thank you, [Bridgette]. Good morning. As you now, our third quarter results were released this morning and are available on our website.

Today's call may include forward-looking statements which represent Virtu's current belief regarding future events and are therefore subject to risks, assumptions, uncertainties which may be outside the company's control. And our actual results and financial condition may differ materially from what is indicated in these forward-looking statements. It's important to note that any forward-looking statements made on this call are based on information presently available to the company and we do not undertake to update or revise any forward-looking statements as new information becomes available.

We refer you to the disclaimers in our press release, and encourage you to review the description of risk factors contained in our final S-1 registration statement and other filings with Securities and Exchange Commission.

In addition to GAAP results, we may 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 our operations and core business performance.

You'll find a reconciliation of these non-GAAP measures to GAAP terms included in the earnings materials with 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/or expenses, and all brokerage clearing exchange rebates and/or fees.

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

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Now, I'd now like to turn the call over to Doug.

Douglas Cifu - *Virtu Financial - CEO*

Good morning, everyone and thank you for joining our call this morning to discuss Virtu Financial's third quarter results. I'm pleased to announce the third quarter was one of the strongest in our history in terms of revenue and profit.

During the third quarter, we saw in an increase demand for our market making services in many markets in which provide liquidity and particularly within our global equities categories.

As a result of this increase demand for our market making services, we generated $138.6 million of adjusted net trading income during the quarter. As was noted -- it's noted in our press release form earlier today, we saw a significant increase demand for our prices as global equity markets became more volatile in late August 2015. In short, the third quarter demonstrated again the benefit of our broadly scaled diversified market making business.

During the third quarter, we continue to maintain discipline around expenses. Our stable cost platform allowed us to generate a 71.3% adjusted EBITDA margin during the third quarter and an adjusted EPS of $0.40 per share.

As we have noted in the past, one of the key attributes of our business model is that our fixed cost plan provide significant business scale and periods of increased volumes and volatility, as is evidenced in the third quarter margins and resulting adjusted EPS for the period.

Before I turn the call over to our Chief Financial Officer, Joe Molluso, let me focus the bulk of my remarks here on the diversification and durability of our model and how it responded to the conditions in the third quarter and then make some general comments and remarks on recent regulatory initiatives.

As we have consistently noted, market volumes are the primary driver of our revenue. Q3 saw volume increases across most of our categories, especially in global equities. US equity volumes were up 29% versus the prior year and up 15% versus the prior quarter.

Our America's equities category generated $45.8 million in adjusted net trading income during the third quarter or an increase of 76% versus the prior year and an increase of 65% versus the second quarter.

As I have mentioned in public remarks around the late August events in the global equities market, Virtu performed especially well in this market environment. We provided two-sided liquidity throughout the end of August; throughout the end of August market volatility and on August 24th in particular.

With regard to our European and Asians equities categories, benchmark volumes were up 16% and 18% year-over-year respectively in both categories. We are quite pleased with our continued long-term growth and performance in Europe and Asia, as our adjusted net trading income was up 22% in Europe and 87% in Asia versus lasts year and up 10% in Europe and 32% in Asia versus the prior quarter.

On average in Q3, we generated 441,000 per day from Europe and Asia, which combined consisted of approximately - which combined consisted of approximately 20% of our overall adjusted net trade income.

Growth in these regions has been deliberate, methodical and continues to be a focus. We view these markets as significant opportunities for Virtu given our experience and scale advantage in electronic transparent and competitive market.

Our commodities business continues to generate favorable and steady results. Our commodities category increased 53.2% year-over-year and was flat versus last quarter.

With regard to currencies, our adjusted net trading income was down about 8% year-over-year and down 6% versus the prior quarter.

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Our currencies category is up 27.8% year-to-date 2015 versus year-to-date 2014. We saw mix performance in the benchmark volumes we look at. CME future volumes were down 3.7% versus last quarter and up 8.6% year-over-year.

Spot FX platforms like Hotspot, Reuters and EBS reported mixed volumes in the third quarter. We are very pleased overall with our FX business. As we pointed out in the second quarter our FX business overall is much more diversified then ever and poised to benefit from volatility in the currency market whenever it arises.

Options volumes were up overall and with increased volatility our business in fixed income, options and other products was up 18% versus the quarter and up a 11% year-over-year.

Now, I want to spend some time discussing the overall environment and some of the topical regulatory proposals that are being discussed globally.

In particular, the CFTC has recently outlined plans to regulate automated trading. We applaud the CFTC for these efforts and we believe the recommendations are consistent with the proposals Virtu put forth publicly nearly two years ago.

Specifically, as we expressed in a letter to the CFTC commenting on rule proposals in January 2014, Virtu supports the CFTC in its efforts to ensure a fair and transparent marketplace in part through registration requirements.

We are registered as a floor trader and we believe it is imperative that participants that seek direct market access to our US futures exchanges be registered and regulated by the CFTC.

Our business is built on proper operating risks controls and we believe that all market participants should be held accountable to time tested standards of risk control around order entry. We therefore also support the CFTC's efforts to ensure best practices, particularly when it comes to proper risk monitoring. Overall, we are encouraged by the sensible recommendations put forward by Chairman Massad and his colleagues and we look forward to lending our support as part of the final rule making process.

I also want to mention MiFID II as it has been in the news lately as it approaches final adoption. We support the goals of MiFID II to bring market firms and proprietary trading firms within the scope of the EU regulatory framework. When Virtu opens its first office Dublin in late 2009, we immediately sought out of regulation of the Central Bank of Ireland and have been registered as an investment firm in Ireland since in August 2012.

As a regulated participant in the European markets, we have long supported market making requirements and transparent quoting obligations, as part of the global financial ecosystem and so we applaud those proposals.

We also believe that one of the competitive benefits of MiFID II for Virtu will be to grow its market share in European equities, in particular the opportunity to price and provide two-sided liquidity in European ETFs, as they migrate more from OTC style trading to transparent and competitive markets.

As we have consistently noted, we believe that regulations which requires registration of participant firms and promotes the fair and transparent pricing of trading of financial instruments provides a significant tailwind to our business model.

As noted in our press release, consistent with our practice since the inception of Virtu, we are returning capital to our owners. Our Board of Directors has declared a $0.24 per share dividend which is payable on December 15, to shareholders of record on December 1, 2015.

As we described in the recent road show and prospectus for our initial public offering, we understand that we manage Virtu for the benefit of our owners and a comprehensive capital return policy will remain the hallmark of this firm going forward.

Our business model performed exceedingly well this quarter in market conditions that were volatile and high volume. We experienced no technology issues or capacity issues and continue to make markets and provide liquidity throughout the quarter, especially during periods when demand for that liquidity was high.

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The event of August 24 allowed us to demonstrate the ability of Virtu to provide liquidity in times of heightened volume and volatility. We made markets in individual equities, ETFs and equity futures throughout the morning of August 24.

Much has been written and said about unusual volatility and activity in ETFs and equities on that date, we welcome the dialogue and the opportunity for harmonizing the market structure across equity and futures markets, as well as improving the market structure around opening and closing auctions.

We continue to believe that the strength of the firm is our broad diversification and significant operating scale. Our prices are distributed to more than 225 unique exchanges, markets and liquidity pools in 35 countries around world. The outlook for our business for the remainder of the year and long-term remains positive.

Now, I will turn the call to over to our Chief Financial Officer, Joseph Molluso, to review our financial results for the quarter in more detail. Joe?

Joseph Molluso - *Virtu Financial - CFO*

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

Our GAAP net income for this quarter before attribution to non-controlling interest was $69.5 million, which equates to $0.35 per share of diluted GAAP EPS. Consistent with the financial presentation in our S-1 registration statement and recent quarterly results, we provide non-GAAP financial information to supplement our presentation.

On a non-GAAP basis, our adjusted net income, excluding mainly the impact of stock based compensation, investing stock based awards granted at the IPO was $76.2 million for the third quarter. Assuming a normalized tax rate and 138.9 million fully converted shares outstanding, this equated to $0.40 per share in adjusted EPS. Our adjusted EBITDA, which again excludes the impact of stock based compensation was $100.7 million for the quarter with a corresponding margin of 71.3%.

Now let's turn to adjusted net trading income and the various categories. With regard to the third quarter results, our total adjusted net trading income was $138.6 million, up versus the third quarter of 2014 by 34.3% and up year-to-date 29.4%.

Adjusted net trading income was up in all categories versus the third quarter of 2014 except global currencies. Year-to-date, adjusted net trading income was up in call categories except the only options, fixed income and other.

On a daily basis, adjusted net trading income was $2.166 million per day, up 34% from the same period one year ago. Year-to-date, we are running at $2.09 million per day through September 30, a 29.3% increase from $1.6 million per day at this point last year.

In reviewing FX performance, we also turn to broader volume benchmarks as performance indicators and reviewing volumes on select spot FX platforms such as Hotspot, Reuters and EBS, the volumes are more inline with our performance. In any given quarter, our results versus any of these benchmarks maybe better or worse.

On the expense side, our third quarter results were as expected. Core expenses, including communications and data processing, employee compensation and operations and administrative, taken together these three categories were down 2% this quarter.

Communications data processing, which includes what Virtu pays in connectivity related fees, as well market data to connect to over 225 venues around the globe was down 7% compared to the third quarter of 2014. Year-to-date, this expense is up 2% inline with how we expect this expense line to grow.

Employee compensation was up 10% for the quarter, compared to the third quarter of last year and is up 9% year-to-date. On a comp to net revenue basis however the third quarter ratio was 17.2% compared to 20.8% last year. On a year-to-date basis, the comp to net revenue ratio was 16.5% versus 19.5% last year. We would expect full year results to continue to reflect this operating leverage.

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We remain motivated to manage expenses aggressively. We are particular vigilant about managing IT and technology related expenses and optimizing our global network. We think we compare favorably to competitors in this regard.

Our margins remain strong in the second quarter with adjusted net income margins and adjusted EBITDA margin at 54% and 71% respectively versus 46% and 63% in the prior year third quarter respectively.

Year-to-date, we've achieved a 55% adjusted net income margin and a 70% adjusted EBITDA margin. As mentioned earlier, our Board of Directors is authorized a dividend of $0.24 per share payable December 15 to shareholders of record on December 1.

A word about the dividend, during our IPO, we discussed various forms in which we would continue the longstanding policy of Virtu to return to shareholders 100% of the free cash flow. We settled on a targeted fixed quarterly dividend of $0.24 per share. We have talked in the past about the variability of our revenues and the possibility quarterly results could vary meaningfully, depending on market volumes and overall conditions.

We are comfortable with the current significant targeted fixed quarterly payout to [away] some of the quarter-to-quarter volatility inherent in our business and reflect the long-term confidence we have in Virtu. We will revisit the dividend from time to time with our Board of Directors to determine if we are in a favorable position in terms of free cash flow.

Finally, looking at our company as fully taxed C-Corp with all the shares converted to the public company, our fully tax adjusted net income would have been $55.2 million or $0.40 per share assuming a 138.9 million shares outstanding.

Now, I will turn the call back to the moderator for Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Our first is from Rich Repetto from Sandler O'Neill. Your line is now open.

Richard Repetto - *Sandler O'Neill - Analyst*

Yes. Good morning, Doug, good morning, Joe. And congrats on a strong quarter here. So my question, I think everybody is going to ask this is, you know, with sustainability, so you've had these quarters that you have, the $138 million in net trading income, then you sort of have the base, you've had three or four quarters of the 105 or 100 to 105 or so? I guess the question is, is there anything from this quarter that you can take that is sustainable that provide you sort of a lift off going forward, to sort of up that base when you don't have the high volatile quarters like we had in 3Q?

Douglas Cifu - *Virtu Financial - CEO*

Yes, thanks. And good question, Rich. I think there is a couple notable takeaways from the quarter, which were - and obviously as you point out, our Americas equity segment was up significantly and that's obviously a large portion of that relates to the events in late August, where there is excessive volume and volatility and we captured a lot of that.

But if you focused really on what we've accomplished in Europe and Asia, I think in the equity segment, I think that's significant and it also is not reflective purely of volume.

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So if you look at European equities during from the second quarter to the third quarter, they were down quarter-over-quarter and our adjusted net trading income was up. If you look the Tokyo Stock Exchange volumes from second to third quarter, they were up around 3.5%, but our adjusted net trading income was up over 32%.

So some of that clearly relates to volatility and uncertainty coming out of China, which rippled through global markets towards the end of August 2015, but I think you are seeing qualitative growth in our business and that's something we always strive for.

I talked about this for the last couple of years and particularly in the road show and on the last call. But we look at our business model, over the long-term, we've historically grown at high single digit growth rate. If you look at adjusted net trading income from '12 to '13 to '14, it went from around $366 million in '12 to $414 million in '13, to $435 million-ish in 2014, Rich, that's like a 9% growth rate. Obviously, I'm not going to project through the end of '15, but we're at $393 million-ish through the end of third quarter. So you can put into your model and kind of extend out that growth rate, if you will.

So this is a firm that I've encouraged people to look at over the long period of time. It's our job and my job as a CEO of this firm to go from the bottom left to the upper right quadrant and grow the firm on a steady state single digit basis or double-digit basis and we ca do that, and I think we've accomplished that.

So there is going to periods and events like the end of August, which this firm is built to capture. But I think if you look at the firm over the long period of time and our long term investors I think get this, this is a firm that is consistently and steadily found ways to grow.

Richard Repetto - *Sandler O'Neill - Analyst*

Got it. Very helpful, Doug. And then I guess my one follow up question, would be the Asia Pac equities had a record quarter and I'm sure that was driven by the volatility overall in China and Asia. But I guess the -- an update on that number, the number for the quarter and then the growth initiatives in China specifically?

Douglas Cifu - *Virtu Financial - CEO*

Sure. So as I was just mentioning, people focus on August; the events of last of August as if it was only a US equities event and it only happened on August 24. And clearly, there was some severe market disruptions and volatility in August 24. But that day in the period really commenced on August 23 New York time out of the news of the about the growth rates in China, right. And so our firm is truly a global firm. We feel the impact of those types of events locally in our Singapore office and its manifest in what we do in Japanese equities and in lot of others countries Korea, Hong Kong, Thailand, where we are a very significant market maker and cash equities, Australia.

And so when you have events like that, they are very, very beneficial to that segment and I do want to reiterate, I think we've grown nicely in Japanese equities in another market segments. We trade a lot of futures out there as well. And so it's an area of growth, we've only been there a couple of years. And so I think there is more we can do in that segment.

With regards to China, I talked about it in other calls. Obviously, there is a lot of uncertainty around the regulatory regime. We've dipped our toe into the water. The results are positive, but very immaterial for what we're doing. So we're really in a test phase there, trading only futures and being very cautious and careful as to how the regulatory regime evolves out there.

Richard Repetto - *Sandler O'Neill - Analyst*

Got it. Thanks. And congrats on the great quarter.

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Douglas Cifu - *Virtu Financial - CEO*

Thanks, Rich.

Operator

Thank you. And our next question is from Alex Kramm with UBS. Your line is open.

Alex Kramm - *UBS - Analyst*

Hey, good morning, everyone. I think Joe when you were going through the review, you gave a third quarter to date number. I didn't catch it completely. So maybe you can just repeat it.

But more importantly around that, can you give us little bit more color what you're seeing so far this quarter and what areas are doing well and what areas we should be focusing on where maybe volume is not a good predictor so far this quarter, but maybe something else has changed on the volatility side to really pay attention to? Thanks.

Joseph Molluso - *Virtu Financial - CFO*

Are you -- the first part of your question Alex referred to year-to-date?

Alex Kramm - *UBS - Analyst*

No, no, quarter to date, just your October update?

Joseph Molluso - *Virtu Financial - CFO*

Okay, for October. Look, we haven't seen any as August 24th like events yet right in fourth quarter. But we've seen solid performance across our businesses. Obviously, it remains early in a quarter and I think as Doug said, we look at this over the long-term. We're not -- we've grown historically high single digits in periods where there isn't a lot of volume volatility. So again, that's what we look at over extended periods of time.

Alex Kramm - *UBS - Analyst*

Okay. And then I guess, secondly, maybe just shifting to the expenses for a second here. I think the comps are probably going to be one that's most volatile first quarter, you've started pretty big, you over accrued then you kind of [paired] back a little bit. Third quarter seems to be kind of normalize rate, but depending on what happens in the fourth quarter, can you give us any sort of bands in terms of any sort of net trading income numbers in terms of how much would you need to still accrue if you have another [blow] up fourth quarter or if actually things stay kind of like they are looking right now. So maybe just a little bit of a vantage, a band, so we see the variability there?

Douglas Cifu - *Virtu Financial - CEO*

Yes, I'll let Joe answer that question, but I wanted to just want to make general comment about competition then Joe can give you the percentage of net income range that we look at.

But you have to remember that we view Virtu, this is not a trading firm, it doesn't have trading firm compensation model. It's not a star culture. We don't have guarantees. We don't groups. We don't have pods. We don't have people like a 40% of trading results. It's never been the construction of this firm.

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This is an all for one, one for all culture. Obviously, we like to reward our folks very well. 75 of our 150 employees were pre-IPO partners in the firm, everybody received stock options when we went public. So it's a very cohesive and properly incentivized firm.

But this is not a firm where if you see results double, you're going to see compensation double. This is much of a more of, I guess, I would call it a technology firm model of compensation. So I know that makes it a little more difficult to model Ashley. But I think at the end of the day or Alex, excuse me, I think I wanted to make the point that, although we obviously are a trading, we don't view our compensation in a way that is similar other trading firms. Joe, you want be a little more precise?

Joseph Molluso - *Virtu Financial - CFO*

Yes, sure. I mean, Alex, you've got exactly right, that the comp to net revenue in the first quarter was on a high side 17.6%. In the second quarter, we dialed it down to 14%. So through Q2, it was around 16%. This quarter it was around 17.2 and last year, year-to-date, it was 19.5%.

So I would expect that given that the fact that we're through nine months of the year that year-to-date figure is going to be within the range of what we would expect for the fourth quarter. So that kind of year-to-date percentage should flow through.

Alex Kramm - *UBS - Analyst*

All right, very helpful. Thank you.

Douglas Cifu - *Virtu Financial - CEO*

Thanks, Alex.

Operator

Thank you. Next question is from Ken Worthington with JPMorgan. Your line is open.

Ken Worthington - *JP Morgan - Analyst*

Hi, good morning. You mentioned MiFID II and I wanted to see how you thought about fragmentation in the derivative markets from MiFID II. And if you think there might be the same sort of fragmentation that results in the derivative markets that happened after MiFID I in equities and, if so, where do you think there maybe particular opportunities for Virtu?

Douglas Cifu - *Virtu Financial - CEO*

Yes. Thank you. That's a great question, I hadn't focused on it my remarks. I mean, candidly, it's not something that we modeled out. I mean there is obviously a number of very, very embedded incumbent future exchanges in Europe, which we are in active participant on.

I said many times publicly and privately that we very strongly much believe in competition, I don't want to say fragmentation because then you get into debate, well how many exchanges or how many venues is too much and you go through periods of fragmentation and consolidation. But at the end of the day, it would be good thing for our equities franchise in Europe, if there were multiple and competitive future exchanges that listed large index products, that's probably not a surprise.

In terms of handicapping that, I'm really not very good at that. So I would think it's a possibility, I'm not counting on it and certainly we haven't modeled that to our results. But it would be a good thing for Virtu because someone then needs harmonize the prices between those futures

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exchange and more importantly we believe the competition tends to drive down trading cost which ultimately is good thing for our business because it's always reflected in the bid offer spread.

So I'm not sure I answered you question particularly well, but that's probably the best I can say right now.

Ken Worthington - *JP Morgan - Analyst*

Okay. I think it's a fair response. Maybe turning to the FX business, FX had a good quarter, but it doesn't seem to be seeing the benefit of higher volatility this year versus the really the lower levels, particularly in the middle and early part of last year. So maybe you can give us some more granularity on the environment this quarter and why the higher VIX year-over-year doesn't seem to having a more pronounced impact. And then I guess the second part of that is, is therefore forward momentum in VFX and if so how and where should we see it?

Douglas Cifu - *Virtu Financial - CEO*

Yes, thank you. Good question. I mean, this is one segment where we've struggled at, I think everybody struggled to find a single repository if you will that really will reflect what volumes and volatility are like. Everybody knows it's a very fragmented market. There's a future, there is spot. There is forwards, there is swaps. And so there is not particularly great real time repository of market data, volume information that we could all point to and say "This is how we're performing."

What we rely on, obviously, we look what the CME is doing, but that's a very small portion, I think, of the overall market and it doesn't capture a lot of pairs where we do particularly well and some pairs where we don't particularly well. So it's not a great index.

I mean, the one place and I'll give props to my good friend, Chris Concannon, and the folks at Hotspot. If you look at their website, they have started to try to put more consolidated industries views of what volumes were like. And again, I'm just going on what Chris and the guys have reported. But if you look at Q3 versus Q2 '15, it reports Hotspot, EBS, Reuters, FXall in the overall market, in general, it was down about 4.5% and obviously CME futures were down were about 3.7%.

So you had volumes during the quarter that are probably a pretty good indication that global FX volumes were down during the third quarter. So the volatility that we experienced in the summer was terrific for our global equities business and I think the FX business performed fine given the opportunity set, but we certainly didn't experience the up tick in volumes and in volatility in that segment as we did in our global equity segment.

VFX as a method of distributing our prices continues to be a significant portion of what we do. We've added counterparties during the quarter, significantly counterparties, particularly in Europe and Asia where we've enhanced our profile and frankly going public, I think, has been very helpful to having counterparties understand who we are and to be accepting of our prices.

So I continue to be a big -- we continue to be believers that that will be a driver of that segment going forward. And it also helps us expand out the menu, if you will, of currency payers that we trade, we now offer over 80 different currency payers and in different marketplace, there will be different needs for smaller pairs or cross pairs that aren't as active on your EBS, your Reuters and your Hotspot type of venues. And as well, we've seen growth in proliferation of NDFs which we can markets on -- through some of our business partners particularly in Asia. So we're excited about that as a growth area, Ken.

Ken Worthington - *JP Morgan - Analyst*

Great. Thank you very much.

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Douglas Cifu - *Virtu Financial - CEO*

Thanks.

Operator

Thank you. Our next question is from Alex Blostein with Goldman Sachs. Your line is open.

Alexander Blostein - *Goldman Sachs - Analyst*

Great. Hi, good morning guys. Question for you on just the competitive dynamics and the electronic market making space. Doug, you highlighted some of the rules coming out of the CFTC, the environment up until August hasn't been particularly kind, I think, to the space as a whole. So just thinking through what it means from a competitive dynamics for your business, does this create any M&A opportunities for you guys and just to give us a sense kind of how you would have thought about it year or two ago just trying to get sense of is more consolidation reasonable or more reasonable less reasonable today versus a few years ago?

Douglas Cifu - *Virtu Financial - CEO*

Yes. Thank you, Alex, for the question. It's a good question. I mean, first of all, let me just address the regulatory environment what it means to Virtu. And we've always said and people sometimes scratch their head about this, that we view it as a tailwind and a not a headwind. And I'm not talking about Dodd-Frank and Basel III and what that means to the banks, I'm really talking about focusing on our industry proprietary trading firms and forcing them to become direct members and direct regulated registered members. That's always been business model since we started Virtu.

We go to a country, we want to be a direct member, we want to be registered, we want to have direct market access to a marketplace. An so when we go to Europe, we go to the regulators and say "Please regulators as a proprietary market marking firm, you may not have a category for that, but we want to regulated and registered" because know that's where the wave of regulation is going.

And so in Europe, when MiFID II comes into effect or the Germans enact their "high frequency provision bill", if you will. It requires firms to become registered members, that's a significant business advantage to us because we've been registered and regulated and in good standing in Ireland for a long period of time. So we can pass forward into each of these EU countries and on day one and MiFID II won't have an impact.

MiFID II also requires firms that are proprietary trading firms to satisfy market making standards, that right in our wheelhouse, that's what we want and the CFTC is saying the same thing. If you want direct market access to our markets much like the sponsored access rule that the SEC put in place, register yourself here as a swap dealer or floor trader or maybe they will come up with some other category and we've had a lot of conversation with the CFTC about that.

We want those rules to be in effect because we think folks should be registered and should be regulated and regulators should have an idea of what firms are doing and how they're accessing the market. We're concerned about risk obviously of our own firm, but we are also concerned about systemic risk from other market participants. And so we want folks to have the same level of attention and risk controls that we put on the firm. So that's my soapbox speech on regulation and registration.

As far as what does that mean for the dynamic, obviously, there are lot of firms out there whose names, I'm sure some of them you know and some of them I know, some of them I may not even be familiar with that are doing things like what we do or maybe trade different that are either not registered or don't have the infrastructure and the scope and the scale that we do. And that's one of the core strengths for this firm is that we are in the 225 markets -- making markets and 11,000 different financial instrument and so we can apply that fixed cost base across a wide variety of trading.

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If you are smaller firm, if you are just US equities market making firm and you look at our cost base and you apply it across the opportunities set in US equities and add on to that all the regulatory cost and burdens and what not, it's very difficult to solely be a US equities market maker, so you have a decision to make which is are you are going double down, if you will, and spend the money to go into Europe and to Canada and to Asia and open offices and deal with regulation or are you going to want to consolidate with a firm like Virtu.

So there are opportunities out there. We're going to be judicious about them. We don't need to make acquisition. We don't have a compelling need to make an acquisition. We're going to do a sensible acquisitions, Joe and I, have a lot of experience in our prior life's as M&A professionals. So we know how to deals here. We've got the DNA to do it, but we're not going to rush into an acquisition solely for the sake of doing one, we'll do one that we think is accretive and is culturally sensible for us to do and can really result in one plus one equals three. That's really been our -- what we've told folks when we were going public and continues to be our mantra.

Alexander Blostein - *Goldman Sachs - Analyst*

Got it. Thanks for your thoughts. And then my second question was just around cash, clearly the operating environment was a probably little bit better so far this year than what we would thought during the time of the deal and probably what you guys would have thought. So when it comes usage of cash, the quarterly dividend obviously provides a nice support, but how do guys think about the need for excess cash in the business, thoughts about a catch up dividend or variable dividend once a year, kind of a CME model, just updated thoughts on that would be helpful? Thanks.

Joseph Molluso - *Virtu Financial - CFO*

Sure. So from a dividends standpoint, again, we'll look at the payout ratio over a long period of time, right. So obviously the payout ratio this quarter compared to the $0.40 adjusted EPS was a little bit lower. The second quarter, it was a little bit higher, so we'll let several quarters develop before we revisit that make sure it's calibrated the right way.

I think the policy is to return a 100% of free cash flow. We have adequate capital to run the business. We've got access to capital if we need it, we've got as a result of the IPO an unsecured revolver. We have secured line. So we feel like we have enough capital to run the business prudently with a proper cushion.

And then if and when, Alex, we begin to accumulate excess cash flow over a few quarters then we revisit the question of whether it makes more sense to raise the quarterly dividends or do a CME style fifth dividend.

I think we got some views when we get there in terms of what would have more of an impact. I think the quarterly dividends we feel like is a good and generous and steady. We probably lean towards doing something more CME style, but we want a few quarters to develop and look at the payout ratio over a longer period of time before our board decided -- we'd recommend to our board to do that.

Alexander Blostein - *Goldman Sachs - Analyst*

Makes sense. Great. Thanks very much.

Operator

Thank you. Our next question is from Chris Allen with Evercore. Your line is open.

Christopher Allen - *Evercore - Analyst*

Morning, guys. Just wanted to follow up a little bit on the FX markets, doing some channel checks, it sounds like risk appetites particularly the banks have been pulled in pretty materially since Swiss franc events early in the year. I mean, theoretically that created a little bit of an opportunity

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for VFX, I'm wondering if you saw any of this, anything kind underneath the surface within the banks that you're kind of seeing and whether that played through in the VFX at all?

Douglas Cifu - *Virtu Financial - CEO*

Yes. Good question. Thanks, Chris. I think that's probably not a new phenomena, if you will, banks reducing their appetite for risk and not wanting to put large positions on their balance sheet and hold inventories and obviously, there is a lot of regulatory and compliance and other issues that have impacted their appetite for that type business.

You're right obviously, there were some well publicized losses and experiences as a result of January 15. So we continue to see up tick in the opportunities in VFX. Let me be very clear though, clearly we're not going to on our own replace the balance sheet even with some of our competitors replace the balance sheet of these very, very large banks. So I think the whole category, if you will, the whole segment is going through this somewhat seismic change as to how prices are made and people are getting filled and what not and we are an important part of that ecosystem.

Our VFX segment is a lot less correlated with what's going on the CME, obviously we're not trading futures there. So it's probably lot more dependent upon -- a better proxy, Chris, would be as I said before what the folks at Hotspot published in terms of their own volumes and what EBS and Reuters and FXall and some of the other big spot platforms published.

And if you look, if you believe the Hotspot website and what Concannon is putting out, which I do, unfortunately, the overall market was down almost 4.5%, 5% and Hotspot was down quarter-over-quarter and things like that and obviously they are doing their best increase their volumes. But I just think overall quarter-to-quarter, there was decrease demand for pricing in the FX market and certainly that was reflective in what you saw in our performance.

Christopher Allen - *Evercore - Analyst*

Got it. That's it's from me guys, thanks.

Douglas Cifu - *Virtu Financial - CEO*

Thank you.

Operator

Thank you. Our next question is from Bill Katz with Citigroup. Your line is open.

Jack Huller - *Citigroup - Analyst*

Good morning, guys. This is actually Jack Huller filling in for Bill. I guess, my first question is just back to August 24, I understand obviously heightened volumes is good for you guys, but particularly with the ETF disruption, what kind of happens to your capture rate and environment like that, just trying to size how much of a boom that was compared to the rest of the quarter?

Douglas Cifu - *Virtu Financial - CEO*

Yes, I mean, August 24 was global and it wasn't just one day, that entire week and then frankly all of August saw a very nice volume up tick, and then September kinds of get little bit lost in the weeds, but the average volumes in September were over 7 billion shares, about 7.3 billion shares per day, which is pretty significantly as well.

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So it wasn't just one off event, it was quarter of increased volumes and volatility. We've said before and I'll reiterate, in times of volatility, our capture rate will increase because there widening of bit offer spread in market as natural buyers and sellers are more willing to, or less patient, I guess is probably a better way to describe it to get in that position.

So no, we didn't make all of money because there was dislocation for 5 or 10 minutes on the New York Stock Exchange and other exchanges at 9:30 in the morning on August 24, it was -- nothing as simple as that. This was a pronounced period of volume and volatility with a firm, because of our technology and our risk controls and our ability to manage that risk and offer immediacy to natural buyers and sellers, was able to provide, we think, a very good service during that period.

Jack Huller - *Citigroup - Analyst*

Got it. Thanks. And then I guess my follow up, you've mentioned China a little bit and Europe more things coming on exchange, but where else do you see the best opportunities for growth for you guys going forward?

Douglas Cifu - *Virtu Financial - CEO*

Yes. I mean, I think Asia overall and you saw at this quarter continues to be an area where we're growing and lot of marketplaces out there, where we really scratched the surface. Obviously, they're a smaller market than what China and India would be, you guys can look at the volumes and make those determinations.

We continue to be excited about what's happening in the fixed income market. Again, it's immaterial to our results right now, which I view as a good thing. I think you will see and NASDAQ has started this with their eSpeed platform, where they are going to sub-tick marketplace that's called eSpeed Elect and we're going to be an active market maker on that.

So those are good market structure evolutions for us, where marketplaces are evolving and where we're being invited to the party, interest rate swaps, those are marketplaces where Virtu can provide two-side liquidity and we think we can grow.

Our fixed income business right now is a de minimis part of what we do overall, when you see platform like eSpeed coming up with new products, new ideas and trying to evolve their market, frankly to help firms like ours provide that liquidity and make markets more efficient, that's good thing.

One to things that we emphasize on a road show and I continue to emphasize in all the conferences and other calls that I do is that Virtu makes money not because of inefficiencies in marketplaces, we make more as marketplaces become more efficient. And so that always -- people always scratch their head when they hear me say that, but it's very, very -- very true.

As the FX market continues to evolve from a broker controlled marketplace to a more competitive marketplace where non-traditional market markers can thrive, that's a good thing for our business. So the pie is going to grow, the addressable pie that firms like Virtu have access to is going to grow. So even if our market share doesn't grow or goes down somewhat, we're going to see an increase in our overall adjusted net trading income. You will see that happen in the fixed income market.

Now I'm going to sit here and say six months from now or 12 months from now, the interest rates market is going to be 50% electronic, that would be foolish for me to say that. The number of SEFs that have -- that were members of -- we've cooperated with a number of them, you see our names in some of them and we believe that marketplace will continue to grow. It's a product where a firm like ours -- it's a commoditize product where firms like our can provide we think valuable two-sided liquidity provision. We'll see how that happens and how it evolves, but that's a segment we're excited about.

Jack Huller - *Citigroup - Analyst*

Good, thanks. I appreciate it.

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Joseph Molluso - *Virtu Financial - CFO*

Thank you.

Operator

Thank you. Our next question is from Ashley Serrao with Credit Suisse. Your line is open.

Ashley Serrao - *Credit Suisse - Analyst*

Good morning. On MiFID II, just to clarify, you expect no incremental cost from the current proposals as you been a leader on the regulatory front and then can you also just talk about the timeline to realization of the revenue opportunities you spoke about?

Douglas Cifu - *Virtu Financial - CEO*

Sure. Yes, I mean, we are registered, we've been registered in -- with the Central Bank Of Ireland since 2012. We've got compliance folks. We deal with all of the reporting requirement of the central bank. Frankly after three years of working with them, we've established a nice working relationship and good reporting relationship.

Joe Molluso, our CFO, meets with them at least two to three times a year and I go over once a year, as well we've been examined by them. And so it's up and running, and so there will be zero incremental cost to us as a result of MiFID II.

What I'm excited about are a couple of things about MiFID II. Number one, the market making requirements, it's right in our wheelhouse, it's what we do, we provide two-sided liquidity, at or near the inside continuously and a broad number of European equity securities at depth and we've got capital supporting. Those are the three or four tenants of what a market marker should do. We've said that publicly over and over again, we're very, very encouraged that will be a final part of the proposal.

The thing that from a business perspective is very helpful to us is European ETP products or ETF. So if you look and you guys probably have a lot a better statistics than I do and I would frankly just be quoting what a sell-side analyst has said in terms of what percentage of ETP market in Europe right now is trading in OTC environment and what percentage of that marketplace is transacted in the fully transparent electronic way where Virtu to be very competitive.

So three years ago, we had a de minimis and non-existing ETF business. Today, we have a very nice profitable successful ETF business and you see that as part of our European equity segment. We are of the view as ETP products become covered instruments in MiFID II that more and more of those products will be transacted on exchanges, on MTFs, on systemic internalizers, all places that Virtu will have access and Virtu can make prices.

We don't have sales force in Europe. We don't go directly to the buy side and give quotes. We don't have a phone or a chat type of business as some firms do. And so as that marketplace evolves more to a fully electronic market, in the same way as what happened in United States, you will see our market share and our capture rate will increase and our P&L will increase from there.

So MiFID II won't come into effect until January 2017. Clearly, the buy side can always encourage their brokers and their counterparties to send more flow directly to the exchanges. We obviously encourage, that's a good thing for us. But again, I think the trend from a regulatory perspective and more importantly from an efficiency standpoint in the marketplace is trending towards firms like Virtu that can provide that service today.

We price and make markets in literally thousands of ETFs globally every day. We do in a fully automated fashion. We do it with the existing automation and personal that we have. We don't need add people to do that. And so as more of that pie becomes addressable by Virtu, it becomes a near to medium term opportunities for us, that's what we're excited about.

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Ashley Serrao - *Credit Suisse - Analyst*

Thanks for all the color there. And then just follow up on some questions that have been asked today, just maybe you can just tell us, how much money do you make on your most profitable trading day during this quarter?

Douglas Cifu - *Virtu Financial - CEO*

Ashley, we've gotten away from the headlines and histrionics, if you will, around daily events. So we certainly are happy to publish and we do publish what our average adjusted net trading income is, but I'm not going to address what we make on any particular day, it's just not productive and really not part of what the long-term business of Virtu is all about. It makes for a nice headline, but it's really not what this firm is all about.

Ashley Serrao - *Credit Suisse - Analyst*

Okay. Thanks for taking the questions.

Operator

Thank you. And our last question is from Alex Kramm with UBS. Your line is open.

Alex Kramm - *UBS - Analyst*

Yes, hey, hello, again. I thought I'd come back to a follow up [or two] rather. First on the commodities business, I don't think you've talk about as much, it's actually I think the only area you kind of missed my expectation a little bit, so maybe just a little bit more color what the biggest segments are that we should paying more attention to, natural gas versus oil, power, some of those things, so we can model it better in the future? Thanks.

Douglas Cifu - *Virtu Financial - CEO*

Yes, it's a good question. Thank you. I mean, I think you hit it right on the head, which if you look at natural gas, we're a very significant market maker in natural gas. It is not a business segment that -- frankly natural gas prices have been depressed , I don't want to talk about why or how, that's really not my business to do, and frankly, I'm not very good at it.

But if you look at quarter-over-quarter what the implied volatility was in both crude and natural gas, they were both down significantly during the quarter. So crude volatility was down by about 14% and natural gas volatility was down about 18%. The volumes in natural gas were down somewhat, I'm sorry, it's realized volatility, not implied volatility. Thank you. That will have an impact on how we do.

Certainly volumes -- our P&L will track more linearly to volumes, but volatility is generally our friend in particular in commodities markets where natural producers or hedges are more willing to pay bid offer spread to get out along the curve, that's where our strategies will do very well.

So when you have a period where natural gas is hovering in the $2 range, it doesn't really -- there aren't a lot of price level transitions during the day, there is less opportunities for us to provide bid offer market making services in that particularly product.

So I would encourage you to look at some of the volatility numbers. We're happy to share those. We get them from public sources as well, but that's a leading indicator, if you will, or a significant indicator of how we're going to do quarter-over-quarter in that segment.

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Alex Kramm - *UBS - Analyst*

Okay. Great. And then just my last one maybe a little bit bigger picture, but obviously in some markets you connect directly; in other markets, you obviously need partners, brokers, banks. So just wondering with some of the regulatory changes that you discussed earlier and in particular some of the capital requirements going higher for some of the partners you have, the banks, the brokers that are getting squeezed more and more, are you seeing any sort of things getting passed through are - your funding cost, anything increasing and does that impact your NTI or you haven't seen any changes and don't really expect anything?

Douglas Cifu - *Virtu Financial - CEO*

Yes, it's a very good question. I mean obviously, look, the business is not getting cheaper and you are right, there are firms that are either getting out of the business or more importantly, I think, if you talk to some of the big prime brokers, I don't want to name names, they are reducing the number of clients they have and really focusing on how your valued clients that provide more repeatable business. And that's frankly another benefit of our scope and scale.

So we partner with large prime brokers like ABN, JP Morgan, Citibank, Goldman Sachs, CIBC, UBS, I'm probably missing a few. But the common theme is large international money center banks that have made a strategic decision that they want to be in the prime brokerage business and are financially stable, I hope.

And those banks see us a very good partner because we're global and we're very active. So we have relationships with all of the aforementioned in every one of the regions around the world. And so we'll provide them with volume in Japan, but we can also provide them with volume in Brazil and in the United States and all the European countries, and these guys very much want market share and want volume and what not. And so at the end of the day, we are viewed as very, very good customer because we're high volume, we're low touch, we've been in business with them for a long time, they understand our risk, we're very transparent with them, parenthetically it doesn't hurt that we're now public reporting company and we have publicly available financials, so their risk folks are more comfortable with us.

So at the end of the day, I wouldn't suspect that our commissions expense line, if you will, is going to down, it's certainly not. I mean the cost of trading won't go down. But I think as a larger firm that has global scale that can offer these folks market share and volume and therefore revenue across the globe, I think assuming they are not going to get out of the business, I don't think they all will, we'll continue to be valued customer of these firms going forward.

Alex Kramm - *UBS - Analyst*

All right. That's great.

Douglas Cifu - *Virtu Financial - CEO*

Operator -- I'm sorry, (inaudible)?

Alex Kramm - *UBS - Analyst*

That's it's. Thanks very much, it was good color.

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Douglas Cifu - *Virtu Financial - CEO*

Thank you very much. Well, I think we're done. So I appreciate everybody taking the time this morning to listen and to ask great questions. We continue to be available to answer any questions if folks have and we look forward to talking to you when we're done with our fourth quarter. Thanks very much.

Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program. You may all disconnect. Everyone, have a great day.

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