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VIRT - Q4 2016 Virtu Financial Inc Earnings Call

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Virtu Financial conference call announcing 2016 fourth-quarter results. (Operator Instructions) I would now like to introduce your host for today's conference, Mr. Andrew Smith, Head of Investor Relations. You may begin.

Andrew Smith *- Virtu Financial, Inc. - SVP, Head of IR and Corporate Strategy*

Good morning, everyone. Thank you for dialing in. As you know, our fourth-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 beliefs regarding future events and are therefore subject to risk, assumptions and 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 is 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 disclaimers in our press release and encourage you to review the description of risk factors contained in our annual report on Form 10-K and other filings with the Securities and Exchange Commission.

In addition to GAAP results, we may refer to certain non-GAAP measures including adjusted net trading income, adjusted EBITDA and adjusted EBITDA margin. You will find a reconciliation of these non-GAAP measures to GAAP terms included in the earnings materials with an explanation of how management uses these measures.

Speaking and answering your questions today 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.

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

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Thank you, Andrew. Good morning and thank you all for joining our call this morning to discuss Virtu's fourth-quarter and full-year results. I am very pleased to report that our global business performed well in the fourth quarter of 2016.

For the quarter, Virtu reported adjusted net trading income of $100.3 million and $0.24 per share of adjusted EPS. The fourth quarter was really a tale of two quarters. October volumes and volatility were similar to the third quarter which was marked by a low volume and muted volatility environment.

The US presidential election in early November brought us a much welcome change to market conditions as we saw an uptick in demand for our market making services across all of our asset classes globally and these positive conditions carried on through the first half of December.

Although the year end was characteristically quiet, we are generally pleased with Virtu's solid performance and profitability in this quarter and the full-year 2016 given the overall market condition.

We could not have achieved the consistently profitable results in this quarter or the full-year 2016 without our diversified, global and scaled platform which continues to perform well in all market conditions and, as well, our relentless focus on costs.

Despite the challenges of a mixed operating environment during much of 2016, I believe the first full year as a public company for Virtu was successful in several respects. First, we maintained what we believe are best-in-class margins for a market making firm despite the mixed operating environment and the additional cost and expenses associated with operating as a public company.

Secondly, we broke ground on expanding our technology offerings by launching our technologically driven agency execution business and entering into an agreement with JPMorgan to provide outsource technology and market structure expertise to a part of their US trading operations.

Next, we acquired a minority stake in Japannext and expanded our footprint in the increasingly important Asia-Pacific region as the year-over-year growth in our APAC equities business demonstrated.

Next, we acquired strategic telecommunications assets from a trading firm allowing us to stay on the forefront of technological developments in our industry while maintaining cost discipline. Also, although there were a number of notable events on the regulatory front, we saw no material negative impact to Virtu's business from anything in the regulatory environment and, in fact, the finalized MiFID II regulation, for example, should be a strong positive for our business going forward.

We are optimistic about 2017 and believe with the new pro-growth and pro-business environment in Washington that the stage is set for the return to a more normalized volume and volatility environment globally and a more sensible regulatory and enforcement environment. As such, we look forward to creating more value for our shareholders in 2017.

Now let me touch on some thoughts related to our business, the environment for 2017 and some strategic initiatives underway at Virtu. With regard to the operating environment, it is worth noting that as a technologically enabled market making firm, Virtu's business thrives as natural buyers and sellers in each of the 235-plus marketplaces that we connect to in 36 countries trade.

In periods of elevated, anticipated or actual volatility, these interactions tend to be more frequent and, therefore, more profitable. Measures of anticipated volatility, like the VIX, and realized volatility were particularly low in the fourth quarter and, in particular, for the entire second half of 2016.

Looking ahead, we see reasons to be optimistic with several underlying factors that have the potential to create favorable levels of trading activity including changes in Fed and global central bank policies and a changing regulatory and tax environment that will allow banks and other market participants to increase their trading activity.

In addition, as a fully diversified market making firm, global geopolitical uncertainties, both scheduled and unscheduled, will continue to lead to enhanced market making opportunities for us across markets.

Turning to some strategic initiatives we started in 2016, I will first talk about our initiative to offer Virtu's superior routing capabilities to the buy-side in equities. Those of you who follow Virtu know this business got underway around the time of our IPO when we responded to critics of so-called HFT by engaging directly with various market participants.

We demonstrated how Virtu operates with our passive market making approach in a non-conflicted and technologically enabled manner. I am pleased to report that we now have multiple buy-side clients up and running sending us order flow every day. We have a meaningful queue of customers to onboard and are onboarding clients in Europe as well. We believe that the European approach of requiring unbundling of agency services as mandated by MiFID II will only make our non-conflicted routing capabilities more attractive to the buy-side.

More importantly, from our perspective, the feedback we have received from our customers to date has been outstanding. As you know, this is a competitive marketplace and, so far, the early feedback we have received fits squarely with how we see the business evolving.

We began this business not to compete with long-established market participants who can offer a variety of products and services to clients, but to create an offering with superior capabilities and analytics that we can service in a Virtu way without incurring meaningful start-up costs and profitably operating from day one.

With regard to technology services, we continue to be excited about the prospects for this business and the ongoing discussions we are having with potential customers. We believe the time is right for an efficient multi-asset class technological platform like Virtu to be sought after by global financial institutions concerned about future technology spend.

The agreement we signed with JPMorgan in July, for example, is up and running and, from our standpoint, is working quite well. We see great long-term potential with this arrangement based on our early interactions.

We have also been approached by other global financial institutions that seek to understand how our technology, global scale and understanding of markets and market structure might help their businesses and we will continue to explore partnerships like these that enhance shareholder value.

Turning to our investment in SBI Japannext, we stated when we made this acquisition that it was a meaningful opportunity for Virtu to increase its footprint in Asia. So far we are very pleased with the investment. We view the market structure in this part of the world as evolving favorably for us.

Although we are not generally disposed to make strategic investments, Japannext has given us the opportunity to have a front-row seat participating in and influencing this change in that part of the world.

We view Japannext as the top PTS in Japan run by a world-class management team and has provided us a unique opportunity to provide our market making services in a large, established market with a top-tier business partner. These interactions contributed to the 11% growth of our APAC equities business from 2015 through 2016, which is impressive growth in a challenged environment.

Finally, we announced in the fourth quarter our intention to purchase strategic assets, telecommunications assets, from a trading firm. We are excited about this acquisition for several reasons.

First, it is an example of how the competitive environment in our industry favors large scale global firms like Virtu. That firm's decision to shift its focus and unwind its proprietary business in favor of an asset management model is a great example of the scale required to compete.

Second, the assets we are acquiring are world-class and will allow us to maintain our superior technological footprint in a cost-effective way.

And third, along with the purchase, we acquired professionals that are already working in Virtu in this area.

We think 2016 was a positive year for the ongoing market structure debate in the United States and globally. A few areas to note; first, we view the Tick Pilot as a real success. As a market maker we have been able to provide more depth of book and quote more names included in the Tick Pilot.

Second, we remain supportive of the recent approaches by the New York Stock Exchange and the Chicago Stock Exchange around new speed bump proposals. As I said in a prior call, we particularly applauded the constructive solution put forth by the Chicago Stock Exchange, which we believe would promote greater liquidity and price discovery by protecting the markets' liquidity from market participants solely seeking to opportunistically profit from short-term price fluctuations.

We also support the ongoing discussions around the efficacy and necessity of our existing order protection and market access reform and remain committed to working with regulators and other market participants in this area. In particular, we are focused on the recent debate around market data and the current system around selling market data.

We continue to believe that there is something fundamentally wrong with how the current system works and the regulators' endorsement of global exchange economic models based on charging market participants, like Virtu, for data that we create in a somewhat noncompetitive fashion. Outside of US equities, we continue to support real-time trace reporting of US treasuries to bring needed transparency to this market.

And finally, we welcome the opportunity to work with the CFTC and Acting Commissioner Giancarlo in implementing a very sensible Regulation AT. Overall, we believe that the change of administration and attitude towards markets in Washington will be a strong positive for our business in 2017 and beyond.

Despite the mixed environment that persisted for much of 2016, we have reason to be very optimistic about the future. I will turn to some specific comments about the fourth quarter before turning the call over to Joe for more review and then, of course, your questions.

Our Americas equities category turned in a strong performance in the fourth quarter. Our average daily results were up 29% despite volumes up only 7% and realized volatility coming in 10% lower than Q3.

Our European equities category performed similarly well. Together these categories were 30% and 11% of our adjusted net trading income overall for the full-year 2016.

While we had a slower quarter in APAC, 2016 was a banner year for our APAC equities category. We completed the aforementioned Japannext investment, expanded our footprint and improved our trading. Our APAC category contributed 12% overall to our 2016 results and we are very pleased with this progress.

As you know, our global FX business has borne the brunt of this recent challenging environment. We saw improvements in our results in the fourth quarter and are optimistic as ever about the future of our FX business after making significant infrastructures and other investments in 2016.

Venues more focused on spot volumes, which are more pertinent to Virtu's business, experienced mixed volume results in the fourth quarter and most were up only modestly while volatility remained quite low.

Our average daily results in the fourth quarter were up 21% versus the prior quarter, which outpaced the volumes in the quarter, so we are very pleased with this performance.

Our commodities business results in Q3, you will recall, included a trading gain from a prior settlement of $3 million; so when excluding the $3 million revenue, our global commodities business was generally flat from the prior quarter and in line with volume expectation.

Finally, as Joe will outline, we kept our promise to our investors by managing our expenses during 2016. In addition, our Board decided on a $0.24 per share dividend payable to shareholders of record on March 1, 2017, making a total of $1.68 per share that we have returned to our investors since our April 2015 IPO.

As I have repeatedly said, our Board and management team remains committed to returning capital to our shareholders and I see no reason whatsoever why this policy would be altered in 2017.

Now I will turn the call over to Joe to provide more detail on our results. Joe?

Joseph Molluso - *Virtu Financial, Inc. - EVP, CFO*

Thank you. GAAP net income for Virtu Financial, Inc., after attribution to non-controlling interest, was $9 million, which equates to $0.22 per share of diluted GAAP EPS.

Consistent with the financial presentation in our quarterly and annual results since our IPO, we provide non-GAAP financial information to supplement our presentation. On a non-GAAP basis, our normalized net income was $32.9 million for the fourth quarter. Assuming 139.7 million fully converted shares outstanding, this equated to $0.24 per share in normalized adjusted EPS.

Our adjusted EBITDA, which excludes the impact of stock-based compensation and other items, was $64.8 million for the quarter with a corresponding margin of 62.6%.

Turning to revenues and the overall environment, for the fourth quarter, our total adjusted net trading income was $100.3 million, down 7% versus the fourth quarter of 2015 and up by 6% versus the third quarter.

On a full-year basis, adjusted net trading income came in at $414.1 million down from the record high of $500.7 million in 2015.

On a daily basis, adjusted net trading income was $1.592 million per day in Q4. There were 63 trading days in Q4 of 2016.

For the second year in a row, the Americas equities category earned the largest share of adjusted net trading income with 31% of the total for 2016. The fourth quarter was particularly strong for Americas and EMEA equities compared to the third quarter and given the overall environment.

On a share volume basis, US consolidated equity volumes were up 7.2% versus the prior quarter and EMEA notional value traded was up 11.7%. Americas equities and EMEA equities results were up 27% and 19%, respectively, versus Q3.

We are pleased with these results particularly in light of the continued overall poor environment for a market maker like Virtu. The average VIX was up slightly in Q4 to 14.1 from 13.2 in Q3; however, realized volatility was down from an already very depressed level in Q3.

Further, the ratio of realized volatility to anticipated volatility as measured by VIX was down as well to 63%, the lowest in some time. The story is similar in Europe where implied volatility and realized volatility were both down versus Q3.

In the APAC equities category, we ended 2016 with a record $49.9 million of adjusted net trading income. The poor overall environment impacted results in Q4; however, we are very pleased with the overall progress in this region, which contributed 12% of adjusted net trading income in 2016.

Turning to foreign exchange and commodities, Q4 was a mixed bag, although we saw overall improvement and entered 2017 on a positive note. Our commodities results were flat versus Q3 when you exclude the settlement trading gain included in the Q3 results.

With regard to foreign exchange, ForEx industry volumes were generally poor in Q4. CME futures contracts and notional amount traded were up; however, more pertinent spot volumes were generally down and, in some cases, meaningfully down, depending on the venue.

As Doug mentioned, our view on the underlying factors that drive volume and volatility is bullish; however, given the unpredictable nature of the operating environment, we strive to operate Virtu to be solidly profitable in all market environments.

To do this, we maintain a policy of strong expense discipline and focus on cash flow generation. Our expense management continued to reflect our discipline and we think demonstrates our ability to adjust to the environment.

Despite the challenging conditions, our profit margins continue to be among the best of our peer companies. We focus on adjusted EBITDA margin and, for the fourth quarter and full-year 2016, our adjusted EBITDA margin was 63.3% and 62.6%, respectively.

On our core expenses, which we include as communications and data processing, employee compensation, operations and administration and depreciation and amortization were, $52 million for the fourth quarter and $208.8 million for the full-year.

We define these categories as core expenses because they represent the fixed costs of operating our business and are therefore somewhat within our control, as opposed to brokerage and clearing-type expenses, which we embed in our trading profits to derive adjusted net trading income.

On a full-year basis, these core expenses were down 3.5% versus full-year 2015. Drilling down into the categories, our global telecommunications and market data costs came in at $71 million up about 3% from the prior year and in line with expectations.

Our operations and administrative expenses were down and our depreciation and amortization line item decreased from $33.6 million in 2015 to $29.7 million in 2016.

We achieved these outcomes with regard to these non-compensation-related expense categories through active management, relentless reviews of our business and requirements, particularly related to technology and market data, but also with regard to facilities, operations, benefits, all aspects of our business. Active management is particularly important with regard to compensation expense.

Looking at the results for full-year 2016, our total GAAP compensation expense, including stock-based compensation, declined from $88 million to $85.3 million. Excluding stock-based compensation, compensation costs were $61.5 million, down from $68.1 million in 2015.

We were able to achieve these results while transitioning to a public company style equity incentive compensation plan for employees, managing our total headcount, which was 146 as of today, while expanding into new businesses and making sure our employees are well compensated and properly incentivized.

The only other notable expense item is the write-off of certain expenses related to the refinancing of our long-term debt. As I mentioned on our last call, we took advantage of favorable market conditions to refinance our debt and, when you do this, we are required to take a non-cash charge writing off expenses related mainly to the unamortized expenses from the previous term loan; and you can see that number is $5.6 million for this quarter.

As you know, the debt refinancing was very successful for Virtu resulting in an extension of the maturity to 2022, the reduction in our LIBOR spread by 100 basis points and decrease in our weighted average interest costs; so we were very happy with this outcome.

Turning to cash and capital, we provide some updated supplemental materials for your review as we did last quarter. Our cash and capital position remains strong providing more-than-adequate capital to run our business and maintain an acceptable cushion.

At December 31, we had cash and equivalents of $181.4 million; net cash was $156.4 million.

We look at trading capital together with net cash, and as you can see, our trading capital position at December 31 was $385.7 million. Given the passive market-neutral approach we have, we do not require substantial amounts of capital to hold or manage risk positions. You can see this analysis on slide 6 of the supplemental materials.

If you look at our EBITDA and income numbers in relation to these capital numbers, you can see that Virtu earns consistently exceptional returns on capital. For example, even in this challenging -- even in the challenging conditions of 2016, we generated $268.6 million of adjusted EBITDA. Using year-end trading capital number of $385.7 million, this translates to a 70% return on deployed capital.

From a cash flow standpoint, we report normalized adjusted net income and EPS to assume that our Company is a fully taxed C corporation with all of the common units exchanged for Class A and B shares in the Company; we feel this is a helpful presentation.

In order to get a picture of our cash-based results on slide 4, as we did last quarter, we have adjusted various items that generate or use cash and, as you can see, the cumulative impact is that we generated $1.99 per share of normalized adjusted free cash flow and declared cumulative dividends of $1.68 per share since our IPO.

We have paid out 88% of our pro forma earnings since IPO. If we cash-adjust these earnings, we have paid out 85% of our normalized adjusted free cash flow. When discussing our payout during our IPO, we communicated our intent to keep the payout at least 70% of our earnings.

Finally, our Board of Directors has authorized a regular quarterly distribution of $0.24 per share payable March 15 to shareholders of record on March 1.

Now I will turn the call back to the operator for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Rich Repetto, Sandler O'Neill.

Rich Repetto - *Sandler O'Neill & Partners - Analyst*

Good morning, Doug. Good morning, Joe. I guess the first question is -- what stands out is the adjusted margins 49%, or close to 50%, and I guess the question is -- and it has been asked before -- but given the environment why don't your strategies struggle like some of your competitors that we are seeing actual quarterly losses?

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Well, it's -- obviously, Rich, I only know what we do, right, so it is hard for me to comment on how other firms run their business or what their strategies do and why they react to volatility and rising markets or falling markets in different ways.

My theory is, and I've articulated this many times, we are a pure market making firm, so we don't have an axe, if you will. What we're -- our mission is to be the finest increment to the bid and offer and to have a price at every moment in time for the 12,000 financial instruments that we trade.

We do that by reference, obviously, to publicly available market data, understanding market structure and having a great technology plan. That is our mission; singularly focused since what Vinnie was doing 30 years ago in the trading pits. You know the story, and we use technology and scale to provide that efficiency to the marketplace.

So, as a pure market making firm, candidly, you should make money in rising and falling markets. Now, obviously, you will make more money when there is more volume and many times you can make more money, as you see in this quarter, where there are periods of volatility or increased interest where the bid-offer spread will expand.

But our mission and our focus and our job, if you will, is to be a service provider, to provide the financial intermediation in the most efficient way between natural buyers and natural sellers. When you do that, and you stick to your knitting and you are consistent and you manage your costs and expenses, which Joe just went through, which we did, frankly, you should be profitable every quarter as we have been since our inception in -- since we started trading in 2009.

Rich Repetto - *Sandler O'Neill & Partners - Analyst*

Understood; that is helpful. And I guess, Doug, you did talk a fair amount about the growth initiatives adding several new buy-side clients and optimistic in 2017. I guess the question -- is there any way to put some sort of quantitative -- how much can this contribute either on a percentage basis or -- just trying to feel what possible impact it could have on the financials in the coming year, the growth initiatives being the buy-side and the partnerships with JPMorgan, etc.?

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Yes, no, look, obviously, I get it and I know you guys and our investors obviously want to see how can we size that opportunity, how can it grow? We do separately disclose in our technology services segment that we have got a couple technology deals and, obviously, now we have an agency business, so it all kind of gets lumped in there.

And we get, at the right moment in time, as that business grows, we will provide more detailed color on it, but I stick with the comments and the statements that I have made on these calls and in other public forum, which is, we think that is a meaningful opportunity.

We have had great take-up from world-class institutions that, frankly, we are very humbled to be in business with -- and you know some of the names that have been out there in the press. And in terms of sizing it, we think it can certainly be 10% of our overall results.

Now the one thing that I am not going to get boxed into is to say -- hey, how is that going to scale out quarter by quarter? And I get it, it is important to the modeling and whatnot people to look at the valuation, and I am cognizant and respectful of that, but we think this is a real opportunity; we have had great uptake.

And I think the thing that I want people to be focused on is we are running those businesses as Virtu businesses. We haven't ramped up with hiring a bunch of new employees and scale and new technology, we haven't made any meaningful investments in there because we frankly don't have to.

What we have discovered is that we are a great financial technology Company that really understands market structure because we have to make markets in these markets. So I think that is a very unique asset, if you will, that we have and the business partners that we are now doing business with, who are very discerning consumers and have, frankly, their choice of any financial technology company out there in the world, recognize that differentiation.

We are not going to be commoditized, we are not going to be the cheapest option, but if you want a firm that really has built a great technological plan, is very efficient, is on the cutting edge but really also understands 235-plus markets in 36 countries, we might be the guy to get -- to do business with.

And so we think that value proposition does scale, does scale in a Virtu way, and we will continue to pound it and, hopefully, you will see the quarter results increase.

Rich Repetto - *Sandler O'Neill & Partners - Analyst*

Thanks. That is all I had, Doug and Joe, and good luck in 2017.

Operator

Chris Allen, Buckingham Research.

Chris Allen - *Buckingham Research - Analyst*

Hey, guys. How you doing? I guess I may just start on cash equities business. If you could just give us maybe some color in terms of what drove the outperformance relative to -- I mean we kind of look at the realized volatility metric; I don't know if it's strength in ETFs or some other element there, and also how the start to 2017 is so far.

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Yes, I mean -- thanks, Chris. Good question. I think -- obviously, and I said it in my comments, some of the -- somewhat, I guess, surprise -- and I don't want this to be a political comment, because it is not -- the surprise election of President Trump and the ripple effects of that, obviously, had a very positive impact on our US equities business during the quarter.

I think the significant thing about that event was, unlike Brexit, which was limited to a day or two or three, Chris, we did see a significant interest and uptick, if you will, in our market making services as is, obviously, seen by the results and the increased capture rate and all the other stuff that you guys will model out during the quarter.

And again, as a leading -- and you hit it right on the head -- as a leading ETF market maker, when you have got people shifting portfolios, when you have got people, particularly on the night of the election, but also the next five, six, 10 trading days thereafter, making fundamental decisions on what does this mean for my portfolio?

And a lot of that is driven by ETP products that we happen to be very active in, very efficient in; that is going to have a significant impact on our operating results in a particular segment in a particular quarter. So it's really -- that was really the offshoot of it.

And again, just to beat the drum again, that is the business model, right? Like try to be everywhere and be the best bid and the best offer in all these different asset classes and geographies, and you will get rewarded.

Obviously, we saw an uptick in the FX business as well. Some of that was related to the improvements in the investments that we have made in terms of personnel and technology but also, obviously, the ripple effects from the Trump presidency certainly helped that business.

January has been interesting. Obviously, coming off the increased volumes and volatilities in November and the first couple weeks of December, we were anticipating that January would hopefully be a more active month.

You guys see the numbers and whatnot; I think there has been a fair degree of uncertainty as to where the Trump presidency policies will come out in the areas of tax, in particular; maybe some of the regulatory structure. So that uncertainty, I think unfortunately, has meant that there is less natural buyers and natural sellers and less portfolio shifting in the market.

And you guys see the volumes in January, which have been somewhat muted and not as robust as we saw in November; but it is still very early days in the quarter. And I am an optimistic guy by nature, but certainly, January -- you guys see the numbers from all the exchanges -- has been somewhat lower than what we saw in November and in the first part of December.

Chris Allen - *Buckingham Research - Analyst*

That is it for me, guys. Thanks.

Operator

Alex Blostein, Goldman Sachs.

Alex Blostein - *Goldman Sachs - Analyst*

Hey, guys. Good morning. I was hoping you could give us an update on the JPMorgan relationship; I think it has been a couple of quarters since the announcement came out. I think in the past, you guys talked about expanding into potentially other asset classes there as well, so maybe just an update on how that has gone so far and what sort of next we should expect from that relationship?

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Well, look, as with every relationship, you're going to date a little bit before you get engaged, before you get married, right? So I think -- look, they are terrific people. I think -- the great results have been -- I think, culturally and ergonomically the firms fit very, very well together.

Obviously, there was a period where we had to get our systems to speak and compliance and all that kind of stuff. That is all now behind us and we are actively engaged in working with them to enhance their market making capabilities in active treasuries and whatnot.

I'm really not going to comment on where it goes from there; I think it is way too early days, Alex. We are humbled and honored, to be candid with you, to be in business with such an important financial institution.

We have learned a lot from them and I hope they have learned a lot from us in terms of how they operate and I think they have hopefully learned on -- how a smaller, maybe more nimble firm operates, so I think there is a lot of great synergies there, but in terms of where the relationship goes, I think it is still early days.

We have got a multiyear relationship with them, multiyear partnership. It is represented in our financial results so you'll see some uptick in 2017, but I think it is, again -- and I have said this on multiple calls -- I think it is a great sign of how large, terrific financial institutions that have customers and capital and all the wonderful things that banks have, can partner with very nimble financial technology firms that happen to know market structure very well. So I continue to be very enthused about the partnership.

Alex Blostein - *Goldman Sachs - Analyst*

Got it, thanks. My other quick question was just around the tax reform and, obviously, it is early days and nobody quite knows where things will shake out but, for you guys specifically, given the Up-C structure and kind of the way you account for taxes on an adjusted basis, if the tax rate were to go down to something let's say in the mid-20%s range, can you give us a sense, I guess, like how that would impact your adjusted results?

And then, more importantly, how does that impact the way you are thinking about the spreads, I guess, or your competitiveness on the pricing side meaning that -- does that create essentially an opportunity because you guys have a lot of scale already and essentially enables you to provide pricing, I guess, in a tighter spread?

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Yes, in my prior life I used to be a lawyer and pretend I was a great tax lawyer, but I actually wasn't, so I'm actually going to ask Joe to give a better answer than I could on what it means for our tax rate.

Joseph Molluso - *Virtu Financial, Inc. - EVP, CFO*

No, Alex, if the corporate tax rate, all things being equal, goes from a statutory rate of 35% to a statutory rate of 25%, we will benefit from that by 10% in terms of how we book taxes. I think the devil is always in the details, and we present it on a pro forma basis because we think that is the right way to do it and we think it -- the right way to value the Company is to assume we are not an Up-C structure and we are a fully taxed C corp.

So we would we see no reason to -- generally, the statutory rate is kind of where your effective rate hovers and we would expect that we would be right around the new statutory rate.

I know there is a lot of detail, a lot of things being discussed about -- having more to do with manufacturing companies probably than a Company like us -- but we would welcome our public company is a C corp and pays corporate taxes, so we would welcome that lower rate.

Douglas Cifu - *Virtu Financial, Inc. - CEO*

And the only other comment, Joe, I would make is -- I should point out -- our offshore operations are based in two lower corporate tax rate jurisdictions, so we are in Ireland and in Singapore and both those rates are 12.5% and Singapore is 15% or 17% depending upon what the category is.

So as a global Company, if the new Washington, if you will, lowered corporate tax rates to 20% or 25%, it really would help us as well because our offshore profits are below that so we wouldn't have to move things around and restructure.

I think you also asked -- like how does it impact the bid offer? I think one of the things that does not get talked about is there is actually a financial transactions tax in the United States; it is called the Section 31 fee. They call it a fee, not a tax; but I will tell you what, it is a tax. It definitely impacts where we can make bid-offer spread and it impacts our profitability.

It shows up in our variable expense line, so people don't talk about it a lot, but it is pretty significant. I know it allegedly goes to fund the SEC and the excess goes to the, quote-unquote, Treasury, but it is a big part of the bid-offer spread and, candidly, if that fee was reduced in a new administration with the new SEC Chairman taking a look at it, that would actually help our US equity results considerably.

Alex Blostein - *Goldman Sachs - Analyst*

Got it. That is very helpful. Thanks, guys.

Operator

(Operator Instructions) Ken Worthington, JPMorgan.

Ken Worthington - *JPMorgan - Analyst*

Hi, good morning. As we think about 2017 and the FX business, maybe talk a little bit about what are your priorities for kind of continuing to get that business to recover? NTR is still well below levels experienced over the last couple of years.

I guess maybe -- how are you thinking about adjusting to both the ongoing market structure changes that the FX environment is sort of going through and then adjusting to just the lower levels of volatility? Are there other things you can invest in and do to kind of grow NTR to those prior levels?

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Yes, good question. I think the -- further, like I will say, fragmentation efficiency of the FX market actually is something that will and does favor a firm like Virtu. One of the things that we did in 2016 with -- and we have seen some success already -- was further automate and scale that business.

Five years ago, six years ago when we were trading FX, and I've said this publicly and privately before, was we had access to four cash platforms in the CME. Scroll forward to 2017 and there's literally dozens of platforms and brokers that we can make markets to for further dissemination of our price and our product offering has scaled considerably.

So applying full Virtu automation and rigor, if you will, to that asset class is something that we really focused on in 2016 and we started to see some of the benefits in 2017.

I think as that asset class becomes more transparent, as you see more competitors, as you perhaps see more real-time price dissemination, as -- if you actually saw some type of centralized clearing -- again I am speculating, right, there is nothing in the works; all of those things, Ken, in terms of market structure are going to benefit Virtu because it is going to start to feel a lot more like an equity style business than more of a bilateral, bespoke type of business and that is obviously very good for us.

I think some of the other regulatory challenges, like we are a significant market maker in NDF swap products, if that becomes easier under Dodd-Frank to do onshore in a competitive SEF environment -- it is not that easy to do right now. It is one of the unintended consequences I think of Dodd-Frank; I think that could be a significant uptick to us.

So expanding the repertoire of pairs that we effectively make markets in, maybe some, I will call it, sensible reformation of Dodd-Frank to enable more competition. I think there were a lot of unintended consequences in the FX market around Dodd-Frank.

I think people can look at that and say -- hey, this really probably wasn't the driver of the financial crisis -- and Dodd-Frank has made it more difficult and more challenging for both dealers and non-dealer market makers to participate in certain type of products, so if there is some sensible reformation, I will say, out of Washington, that is probably a positive to our business.

But again, this is not a business where we are going to go directly to buy-side counterparties, right? We are very comfortable with the relationships we have with the big dealers. We are not going to scale out and have a sales force and all that kind of stuff.

I think there is a lot of room for a very efficient market maker like Virtu to take our prices and effectively redistribute them through business partners that are [being called] banks, technology providers or exchanges or ECNs, whatever you want to call them, there is a lot of room for growth there.

Ken Worthington - *JPMorgan - Analyst*

Great. Thank you very much.

Operator

William Katz, Citigroup.

Jack Keeler - *Citi - Analyst*

This is Jack Keeler filling in for Bill. Thanks for taking the questions this morning. Just first one, on the technology services business, you mentioned you have had conversations with other financial institutions. Just kind of curious how much of this has been you guys fielding inbound calls versus reaching out to these institutions?

And I know you just mentioned about a sales force and I know that is kind of an un-Virtu thing to do, but do you have any dedicated sales people and is that something you would think about doing in the future?

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Yes, I guess I am the lead salesman of Virtu, not to be too flippant; but no -- again, there aren't -- it is not like there are 100 customers here, right? You could probably name on one or two hands the large financial institutions.

I think the great news is, because we are in the market and because we have relationships with your employer and just every employer that is on the phone and others that we do business with either as a trading partner or a prime brokerage customer over the years -- and we have those relationships.

So these were all inbound calls because, obviously, when there is noise around us entering into arrangements and doing various things, I think that raises eyebrows in corridors and institutions and people say -- hey, I want to know what is going on, might just make sense for me to do something as well.

And so I think our reputation with most or all these financial institutions is stellar because we're a transparent, fully regulated market maker and we have had really good business relationships with these folks over the years, so these aren't commoditized products. We are looking for strong, strategic partnerships.

I know I am being vague intentionally, but you kind of get it, which is large institutions look at the efficiency scale and market structure expertise that we can bring. Those are areas within large financial institutions that I understand having talked to executives at these financial institutions where they are kind of trying to figure out what they do and how they can become more efficient in providing services to their customers.

We are all trying to solve the same problem which is -- markets are getting more efficient and end-users are demanding efficiency in pricing.

It seems like a natural fit because we, as a general matter, don't have customers, don't have relationships with the buy-side, don't have research, don't have IPO calendars, all the wonderful things that large financial institutions have and have developed over, frankly, centuries.

It would be silly for us to try to compete with that and we would never do that. But how can you marry the efficiency, scale and market structure expertise that we have with all the fantastic things that a large financial institution can bring?

We have done that now in a couple of instances and might there be opportunities to do that again? Absolutely.

Jack Keeler - *Citi - Analyst*

Got it, thanks. Would it be possible to give any -- is there any color you could give on the pipeline for future technology services deals? Is this something that you have conversations ongoing or is it in the future if more came off you would be interested in doing it?

Douglas Cifu - *Virtu Financial, Inc. - CEO*

I mean they are certainly ongoing, as I said in my script, which means that we are in talks with people; they are in various stages of -- hey, tell me what you guys do, does it make sense to -- let's try something out and see if this might work?

Again, I don't want to sit here and promise and say we are going to sign up two of them in 2017 and this and that. What I have said is this is not going to be a couple dozen business partners. We are a small firm and when we do these things we do them very intensely because we want to prove that we can really provide value to the business partners.

This isn't a question of setting up some commoditized technology algo licensing kind of business; there are plenty of firms that do that and, I assume, do it very, very well.

What we can offer is really a holistic understanding of technology and market structure, which we think is kind of unique, because that is the only way that we make money, right, understanding the markets and being really efficient.

And if we can partner with somebody that needs that efficacy and understanding in a very, very efficient, not off-the-shelf kind of manner we think it -- and it works for them and it works for us, we will do it, but again, I'm not going to sit here and promise that it will be X, Y and Z over the next number of quarters because I think that would, candidly, be irresponsible.

Joseph Molluso - *Virtu Financial, Inc. - EVP, CFO*

And remember, just as you look at this -- as you look at our financials you see -- as we pointed out -- technology services is where these revenues develop and the agency execution piece of this will develop, hopefully, in a more steady way as we kind of onboard customers and that is just the equity agency execution piece. I think what you are asking about is more the technology services/outsourcing which, by its nature, is going to be lumpier.

Jack Keeler - *Citi - Analyst*

Got it. Thanks, guys. And then, Joe, just a question for you. Obviously the expense flux was pretty strong year over year in 2016 in light of a pretty challenging environment. If you see a similar environment in 2017, was there any kind of delayed spend or delayed investment in 2016 that you are planning to use in 2017 instead, or could you kind of stay at current run rate levels if the environment (multiple speakers) challenged?

Joseph Molluso - *Virtu Financial, Inc. - EVP, CFO*

The answer to your question is no, there is not anything that we -- we did not have any forgone expenses, any deferred expenses, any delayed expenses and, I would say, emphatically yes, we can maintain the run rate and we will do what we have to do to adjust to the environment even if, heaven forbid, it got worse.

So we do have continued flex and we feel strongly you've got to be able to make money in all kinds of environments including the quite poor environment in the third quarter and the fourth quarter.

Jack Keeler - *Citi - Analyst*

Got it. Thanks for taking my questions, guys.

Operator

Thank you. I am showing no further questions at this time. I would like to turn the call back to Mr. Douglas Cifu for any closing remarks.

Douglas Cifu - *Virtu Financial, Inc. - CEO*

Thank you very much, operator. Again we thank everyone for their interest in Virtu and for a very successful 2016. We look forward to even more success in 2017. Thank you, everybody.

Operator

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