

FINAL TRANSCRIPT

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MKTX - Q1 2010 MarketAxess Holdings Inc. Earnings Conference Call

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CORPORATE PARTICIPANTS

Trey Gregory

MarketAxess Holdings Inc. - Head of Marketing and Communications

Rick McVey

MarketAxess Holdings Inc. - Chairman, CEO

Kelley Millet

MarketAxess Holdings Inc. - President

Tony DeLise

MarketAxess Holdings Inc. - CFO

CONFERENCE CALL PARTICIPANTS

Daniel Harris

Goldman Sachs - Analyst

Howard Chen

Credit Suisse - Analyst

Hugh Miller

Sidoti & Company - Analyst

Justin Hughes

Philadelphia Financial - Analyst

Chris Donat

Sandler O'Neill - Analyst

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session. (Operator Instructions). As a reminder, this conference is being recorded Wednesday, April 28, 2010.

I would now like to turn the call over to Trey Gregory, Head of Marketing and Communications at MarketAxess. Please go ahead, sir.

Trey Gregory - *MarketAxess Holdings Inc. - Head of Marketing and Communications*

Good morning, and welcome to the MarketAxess first-quarter 2010 conference call. For the call, Rick McVey, Chairman and Chief Executive Officer, will review the highlights for the quarter; Kelley Millet, President, will provide an update on trends in our businesses; and Tony DeLise, Chief Financial Officer, will review the financial results.

Before I turn the call over to Rick, let me remind you that today's call may include forward-looking statements. These statements represent the Company's belief regarding future events that, by their nature, are uncertain. The Company's actual results and financial condition may differ, possibly materially, from what is indicated in those forward-looking statements.

For a discussion of some of the risks and factors that could affect the Company's future results, please see the description of risk factors in our annual report, Form 10-K, for the year ended December 31, 2009. I would also direct you to read the

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forward-looking disclaimers in our quarterly earnings release, which was issued earlier this morning and is now available on our website.

Now let me turn the call over to Rick.

Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

Good morning, and thank you for joining us to discuss our first-quarter 2010 results. We are pleased to report another set of strong quarterly results with record revenues of \$34.9 million, up 42% from a year ago, and record pretax income of \$11.1 million, 134% above the first quarter of 2009. The strong revenue growth, combined with operating leverage, led to a marked improvement in operating margins to approximately 32%. EPS of \$0.17 was more than double year-ago levels.

Variable transaction fees were the largest contributor to revenue growth and were up 64% from a year ago, primarily due to higher volumes. Fee capture per million traded remained strong, and total trading volume of \$99 billion was 65% above a year ago, and the highest since pre-credit-crisis levels in the second quarter of 2007.

Investor order flow into the system was up 24%, and we now have 72 dealers globally, up from 48 one year ago. Our efforts to add new dealers to expand the liquidity pool resulted in better hit rates that continue to drive our trading volumes higher.

Slide four provides an update on the current regulatory reform in our CDS platform. Financial regulatory reform continues to progress through multiple congressional committees. Three proposals have been passed, mandating trading of certain clearable swaps on an exchange or a swap execution facility. Although the final form of any regulatory action and the implementation timeframe are still subject to debate, we see the recent regulatory activity as favorable for electronic trading, and we intend to register and operate a swap execution facility.

We have and will take actions necessary to capitalize on the reform legislation, especially as it relates to credit default swaps. We have already developed CDS trading engines for index, single-name and bid-offer list trading. We have an established a network of institutional credit market participants. Through available post-trade APIs, we can quickly connect to order management systems, confirmation hubs and clearinghouses as our customers choose.

Last week, we announced the appointment of Dr. Sharon Brown-Hruska, a former commissioner of the CFTC, to our Board. Sharon will increase our knowledge of the regulatory environment and its likely impact on derivative trading.

Slide five provides an update on market conditions. Over the past year, credit market conditions continued to normalize with lower credit spreads and credit spread volatility. After peaking in the third quarter of 2008, high-grade credit spreads, as measured by the Credit Suisse LUCI index, continued to decline, ending the quarter at 118 basis points over US Treasuries. Credit spread volatility declined further during the quarter, but remains above pre-crisis levels.

During the first quarter, nongovernment guaranteed new-issue volume was the highest it has been since the second quarter of 2008. The steep yield curve continues to be a driving factor for strong inflows into taxable bond funds and ETFs, creating additional demand for corporate bonds and other credit assets.

All of these factors have contributed to a robust credit-trading environment, which we currently expect to continue for the balance of 2010.

Now let me turn the call over to Kelley for more detail regarding our first-quarter business results.



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Kelley Millet - MarketAxess Holdings Inc. - President

Thank you, Rick. Slide six summarizes the trading volume across our product categories. Overall global volume at \$99 billion was up 65% year-over-year, marking our strongest quarterly result since the second quarter of 2007. In US high-grade, volumes rose to \$62 billion, up 67% year-over-year and 11% from the fourth quarter of last year. Our estimated US high-grade market share of TRACE was 7.9%, up strongly from 5.7% one year ago, but down marginally from fourth-quarter levels.

Eurobond volumes were \$16 billion, up 76% year-over-year, but down 11% from the fourth quarter of last year, influenced by market issues and sovereign debts, and other factors. I will talk more about our European business shortly.

Our Other category, driven by US agencies and emerging markets trading volumes, grew to \$22 billion, up 53% year-over-year and up 16% from the previous quarter.

Slide seven highlights the revenue drivers of the business. US high-grade TRACE volumes remain robust, driven by a number of factors that Rick spoke to earlier. Global fees per million for the quarter of \$172 were down \$8.00 from last quarter and in line with a year ago, but remain well above the levels before the credit crisis. As a reminder, fees per million are influenced by factors such as average duration of securities traded on the system, regional dealer activity and the level of activity of our high-grade execution desk.

Total variable transaction fees were \$17.1 million in the first quarter of 2010, up 64% from the first quarter of 2009, and were 58% of total commissions. We are pleased with the sequential growth of our variable transaction fees over the past five quarters.

Distribution fees were \$12.2 million in the first quarter of 2010. Fees from new dealers have more than offset those we lost during 2008 and early 2009 due to dealer combinations and bankruptcies, and demonstrates the importance of our dealer expansion.

Slide eight highlights our improved client and dealer participation. Hit rates for the percentage of client inquiries that result in trades, continued to improve across all product categories. In US high-grade, we saw a hit rate of 74% by trade count, up from 59% in the first quarter of last year.

The high-grade hit rate increased due to the improvement in market conditions, as well as the increase in the number of liquidity-providing dealers, which grew to 72 from 48 a year ago. The new dealers continued to be an important contributor to liquidity and represented 21% of the number of trades executed.

In addition to the expansion of our dealer network, we are also pleased with the increase in client inquiry count and the growing number of investor firms that traded on the system across all major product categories compared to a year ago. The continued strength of our trading network is not only a key revenue driver, but creates substantial barriers to entry, especially in the US market, and creates efficiency regarding best execution and seamless straight-through processing for our customers.

Slide nine highlights our Eurobond and Other trading categories. European commission revenue was \$5.5 million, up 33% compared to first quarter of last year, although revenues declined 8% from last quarter. Despite a volatile sovereign debt market and greater competition in electronic trading in Europe, we were pleased that the number of investor clients executing at least one Eurobond trade grew about 10% in the quarter.

We are currently expanding our European trading protocols to serve the specific trading patterns of our clients, giving them greater flexibility in how they trade credit. Furthermore, in a market that lacks a TRACE-like reporting mechanism, we are actively working to integrate more robust data and more efficient price discovery into the European system.

Our Other trading volumes increased 53%, and commissions for the category were \$4 million, up 45% from the first quarter of 2009. Within the Other category, the emerging markets franchise continues to grow, and we saw a more favorable balance



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between sovereign and corporate debt trading activity across the platform. We are pleased with this result and look to grow this business and provide greater trading opportunities for our client network. We feel the more products that investor clients trade, the greater the stickiness of the platform, and this leads to more usage of the platform overall.

In closing, our focus remains on expanding our client and dealer network, delivering diverse and appropriate trading protocols to meet the market's needs and providing connectivity that allows our clients to take full advantage of the benefits of E-trading.

Now let me turn the call over to Tony to discuss our financial results.

Tony DeLise - MarketAxess Holdings Inc. - CFO

Thank you, Kelley. Please turn to slide 10 for our earnings performance. Our record revenue of \$34.9 million increased 42% from a year ago, primarily driven by trading volume improvements. Technology products and services also contributed to revenue growth, with a 56% increase from the first quarter of 2009. We have seen signs of improvement in the IT spending environment and are cautiously optimistic on the outlook for the rest of 2010.

Total expenses were \$23.8 million, up 20% from the first quarter of 2009, largely due to higher employee compensation costs and one-time expenses, which I will talk more about shortly.

Income before taxes was a record \$11.1 million, up 134% from the first quarter of 2009. Our effective tax rate for the first quarter of 2010 was 39.5%. We expect our full-year tax rate to be in the range of 39% to 41%, reflecting the benefits of estate tax modifications that we discussed at year-end.

Our diluted earnings per share of \$0.17 was the highest we have generated as a public company. Our diluted share count increased by 1.8 million shares compared to the first quarter of 2009, largely due to the impact that our share price has on the Treasury method computation. Absent any significant issuance or retirement of shares, we would expect the share count to change by approximately 150,000 to 200,000 shares for every \$1.00 change in our average share price for the period.

On slide 11 we have laid out our commission revenue, trading volumes and fees per million. Distribution fees of \$12.2 million were up \$2.2 million from the first quarter of 2009, due principally to the addition of several major dealers over the past year. Excluding any migration of a regional dealer up to the major plan, we expect the distribution fees for the second quarter to be in line with the first quarter.

As volumes continue to grow for certain regional dealers, some conversions to the major plan may occur. We expect any conversions to be revenue neutral, as lower variable transaction fees would be offset by higher distribution fees.

As Kelley mentioned, global fees per million were in line with a year ago, but were down \$8.00 from the fourth quarter of 2009. At a more detailed level, the decline in US high-grade fee capture versus the fourth quarter was due to shorter average duration of bonds traded on the system, combined with a smaller contribution from the hybrid execution trading desk.

The Other Product category fee capture declined versus the fourth quarter due to a larger percentage of volumes and products that carry a lower fee per million.

Slide 12 -- excuse me -- provides you with the expense detail. Total expenses of \$23.8 million were 20% above the first quarter of 2009. Employee compensation and benefits increased by \$2.5 million from the first quarter of 2009 as a result of higher employee compensation -- excuse me -- employee compensation and benefits increased by \$2.5 million from the first quarter of 2009 as a result of higher employee compensation, which is tied to operating performance and an increase in employee headcount. Employee headcount increased from 198 as of March 31, 2009 to 219 as of March 31, 2010. The majority of the new hires were added in 2009 to support the expansion of our dealer and client networks and new initiatives.



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During the first quarter of 2010, we also incurred approximately \$625,000 in one-time expenses related to the move of our new headquarters and the Haiti Charity Trading Day. We are proud to report that we raised and donated \$178,000 to the American Red Cross to aid victims of the earthquake in Haiti.

You will recall that during our year-end earnings call, we provided full-year 2010 expense guidance of \$90 million to \$94 million. Currently, we believe that full-year 2010 expenses are trending toward the higher end of that range, which represents approximately a 10% increase in expenses over full-year 2009.

On slide 13, we provide balance sheet information. Cash, cash equivalents and securities as of March 31 were \$168 million or \$4.27 per share on a diluted basis compared to \$174 million at year-end 2009. The increase in cash -- I'm sorry -- the decrease in cash is largely due to the payment of annual bonuses during the first quarter of 2010 and \$2.9 million of capital expenditures and move costs associated with our new premises in New York City.

Total stockholders' equity, including the Series B preferred stock, was \$253 million as of March 31, 2010, representing book value on a diluted basis of \$6.42. We continue to have no bank debt.

Slide 14 displays our historical cash balances, investment returns and capital management priorities. While we expect that short-term rates will normalize over time, the current rate environment has had a significant negative impact on our investment returns. At current cash levels, every 1% increase in rates would improve earnings per share by approximately \$0.03 annually.

Capital management continues to be an area of focus as we evaluate ways to best deploy our capital. We are investing in organic growth opportunities. We continue to evaluate business acquisition opportunities in additional product segments or to round out our connectivity and market data capabilities. And we also have a program in place to return capital to our shareholders via our regular quarterly cash dividend. We believe that our balance sheet is financially sound enough to pursue all three priorities simultaneously.

Now let me turn the call back to Rick for some closing comments.

Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

Our strategy to expand our institutional trading network throughout the credit crisis is paying off with record revenues and earnings as the markets continue to recover. We are pleased with the growth that we are seeing in all of our major product areas and continue to believe that our operating leverage will drive attractive earnings growth.

In addition to growth in existing product areas, we are excited by the new opportunities emerging as part of the regulatory reform process. We believe the opportunity set for electronic trading in fixed income markets is getting larger.

I would now like to open the call for your questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Daniel Harris, Goldman Sachs.

Daniel Harris - Goldman Sachs - Analyst

Good morning, Rick. Good morning, everybody.

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Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

Good morning, Daniel.

Daniel Harris - Goldman Sachs - Analyst

Rick, you led off with some discussion about regulatory reform, and my guess is most people that are listening have been dealing with this now for some time. Would love to get your thoughts on how you see things progressing and impacting your businesses in cash bonds.

But then also, you started the conversation pretty quickly with a discussion of your CDS opportunities and just -- capabilities. I would love to hear how you think that has progressed in terms of conversations you've been having over the last quarter or two with market participants.

Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

Sure. On the first -- although there is nothing specific in the regulatory reform proposals dealing with cash fixed-income markets, our belief is that if the market comes to the conclusion that more electronic trading is a good idea for the fairness and openness of derivative markets, they will also conclude that it is probably a good idea for cash fixed-income products. So at the margin, we do believe that the discussion around more electronic trading for derivatives will provide a positive benefit in terms of the adoption rates for cash products.

In terms of market participants and the conversations that we've been having around CDS, there continues to be enough [certainty] about the outcome and timing of the regulatory reform proposals that it is fair to say that there has not been a lot of concrete action yet with respect to moving forward with electronic trading of CDS. But I think people are paying very close attention to the various parts of the proposal that include greater central clearing for standardized swaps, electronic execution and increased market transparency.

Daniel Harris - Goldman Sachs - Analyst

Okay. Thanks, Rick. So in a similar vein, Europe, I guess, is to some extent going to watch what happens in the US and then follow in their own suit as they see accordingly.

But my question is they don't have the same kind of structure we have, given their various countries over there, with TRACE reporting or any sort of reporting in terms of cash credit. Do you think that is something they will pursue and that you could benefit from?

Kelley Millet - MarketAxess Holdings Inc. - President

There has been much dialogue around transparency from a more official basis, a la TRACE. We have not gotten any indication that such movement is likely in the short term.

As we look at competing in the European market, it is very clear to us that the offering of multiple trading protocols, i.e. our traditional RFQ, as well as a sort of click-to-trade capability and the integration of price discovery or pre-trade analytics, can be a very powerful combination. In the short-term, as you are well aware, such analytic or price discovery will have to be more derived from trading on our platform, and potentially derived pricing, as you are aware from [ODVUX] or other indices.

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So in the short term, unlikely to see a TRACE-like product, but clearly a great demand from our buy-side clients in enhancing at least pre-trade price discovery, and we are going to deliver the tools for them to begin to do that.

Daniel Harris - *Goldman Sachs - Analyst*

Okay. That was helpful, Kelley. And then just one data point. On Friday, you guys talked about the percent change number of investors that are executing at least one trade, and it looks like emerging markets is really seeing some pretty rapid growth. Any color around that? And how big of an opportunity do you think that could be relative to your US and European businesses? Thanks a lot, guys.

Kelley Millet - *MarketAxess Holdings Inc. - President*

As I addressed EM, obviously, the market has been quite robust. As you are aware, based on the credit quality of the number of the sovereigns and quasi-sovereigns that are more commodity-based, a number of them are high-grade and a number of them are trading from a spread basis in a similar vein.

The growth in our business, I think, has been our ability to get a better balance between what was the typical E-trading, which would be in the large on-the-run liquid sovereigns, with the addition of corporates. And again, there are a number of corporates in Latin America, in Asia and in a handful of places in Eastern Europe that are in fact investment-grade. So like in our high-grade business, we have been adding to our dealer group and expanding our client network as well.

It is a little bit difficult to assess the overall market opportunity because, as you know, the EMTA figures are a little less accurate or a little less comprehensive than the TRACE figures. But we do think that we can continue to grow that franchise in a reasonable vein and continue to offer, in my mind, a diverse set of products across our large money managers and other clients, where we do believe that as they trade credit, both here and in Europe, high-yield EM and agencies, we have a more complete offering, and, as I said earlier, we believe creates stickiness to the system.

Daniel Harris - *Goldman Sachs - Analyst*

Great. Thanks. Tony, hope you are feeling better.

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

Sorry about that.

Operator

Howard Chen, Credit Suisse.

Howard Chen - *Credit Suisse - Analyst*

Good morning, everyone. First one with respect to the current environment in the (inaudible) business, Rick, maybe best for you. You've clearly been the beneficiary of a lot of healing in the markets. Just wanted to get your view, as we haven't heard in a while in the technicals with rates near zero. What are you hearing from the buy side in terms of kind of cash on the sidelines and just appetite to kind of put that to work? Where are we in that kind of conversation, from your point of view?

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Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

I think it is probably consistent with what all of you are seeing. As long as short rates and money market funds remain close to zero, there has been a consistent movement out of short-term money market funds and into longer-term bond funds. So the cash flow has been quite positive into the investment management community that tends to be active on our system. The view is that is likely to persist through the balance of this year.

The other trend that is clear is that most of the money coming out of money market funds is going into bond funds and not into equity funds, which we think is part of a longer-term asset allocation shift, where a greater percentage of investable assets seem to be going into fixed-income product categories.

Howard Chen - Credit Suisse - Analyst

Okay, great. Thanks, Rick. And then one for you, Kelley. In your prepared remarks, you spoke to a pickup in terms of the European competitive landscape. I was just curious if you could elaborate on that a little bit.

Kelley Millet - MarketAxess Holdings Inc. - President

In Europe, whereas in the US, the dominant trading protocol is the use of requests for quote, or RFQ, and such work is typically dominated by the lift business, there is a more varied trading protocol or protocols in Europe.

The large what I will call aggregators of private wealth, not surprisingly in Germany, Switzerland and the like, employ more of a work process that is click-to-trade. So they see a level, they see it in the stack, they hit or lift subject to dealer confirmation.

Bloomberg has a reasonable presence in that marketplace. So what we've done and what we will be delivering is a competing product that will sit aside our RFQ capability and we believe provide a more competitive and compelling offering in that click-to-trade space. That opens up a whole series of investors heretofore that we really didn't have a meaningful dialogue, because that work process dominated their trading day.

So if I can deliver -- and we will -- an RFQ, a click-to-trade and the integration of data and pretrade price discovery, then we think collectively, in toto, we have a superior offering to any one of the individual offerings in the European marketplace.

Howard Chen - Credit Suisse - Analyst

Great. Thanks for that color, Kelley. Take care. Have a great day, guys.

Operator

Hugh Miller, Sidoti & Company.

Hugh Miller - Sidoti & Company - Analyst

Good morning. I was wondering if you guys could maybe talk a little bit about -- given some of the scrutiny maybe some of the larger broker-dealers have been coming under, just regarding concerns about their leveraging practices, maybe leveraging up during the quarter and kind of leveraging down towards the end of the quarter, and some investigation on that, do you think that might influence their market-making capabilities on a go-forward basis? And whether or not you feel that the regional dealers that you have coming online could pick up the slack. But just was wondering if you could give us a little bit of your thoughts and color on that.



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Kelley Millet - MarketAxess Holdings Inc. - President

As you know, through the credit crisis, as you look at the Fed data, the corporate bonds on the balance sheet of the primary dealers fell precipitously through that process. And it really did drive our efforts to expand the liquidity pool by adding dealers to the platform. As I said in my prepared remarks, those new dealers drove about 21% in trade count of our transactions in the first quarter.

I think there are a couple of things to note. It does appear that the larger dealers are using more balance sheet, but they are nowhere near the levels precrisis. Secondly, within that sort of new dealer discussion, there are a number of very large dealers, and not just regionals or smaller regionals. And we thank those that are re-entering or entering to the market for the first time, like a Nomura or a Susquehanna or a Citadel, can add substantial liquidity, given the nature of their capital. Finally, we do believe that the regionals will benefit, given the nature of their relationships, in a sense with their downstream or end buyers or clients.

So in total, I think we see a couple of interesting positive trends. Large dealers getting a little bit bigger, a little bit more important. Within the new dealers, a number of large dealers in a sense new or reentering the marketplace that can provide significant capital to that liquidity market-making. And then the regionals, we feel, having an increased stature in terms of their ability within their defined business model to again add liquidity to our system.

So we think at the margin, those trends should be beneficial to help our hit rate. As we discussed, it is up significantly first quarter to first quarter this year to 74%, and we do believe it has some room to run from there.

Hugh Miller - Sidoti & Company - Analyst

Okay, that's very helpful. Thank you.

Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

Hugh, I would just add to that as well, I think what we consistently hear from our investor clients is that they want a diverse set of liquidity providers to be prepared for any market or regulatory environment. And we think we've been consistently delivering that set to them with the expansion in our dealer community on the MarketAxess system.

And what we are seeing in terms of the momentum and the increase in volumes on the platform, we think reflects the fact that the only efficient way for investors to deal with a larger set of dealer counterparties is to trade more electronically. And we think that is coming through clearly, and we believe that is a long-term trend.

Hugh Miller - Sidoti & Company - Analyst

Okay. That's great. And I guess maybe as a follow-up to that comment -- and I apologize -- I didn't kind of see it in the slides -- I wasn't sure -- but the new dealer approval rates, because obviously you are bringing on the dealers, trying to get them on to your clients' platforms and you know that there is a need for additional dealers that are providing liquidity that maybe some of the others aren't, are you seeing any adjustment in trends there with the client approvals or the dealer approvals?

Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

I think it can be, in a sense, two sides of the coin. What we do see is that for, quote, the large new dealers coming on to the platform, we see an approval process that is slightly higher than the historical or faster than the historical timeframe to approve them to get to critical mass.

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As the liquidity has returned to the marketplace, clients are being a little bit more selective in terms of the approval of certain regionals. So net-net, we feel like we are on track, slightly ahead of pace with the larger dealers, but clearly remains a key focus. And it really does vary by type of investor, by the way in which they trade, i.e. index funds versus insurance companies. But that continues to be a real focus for the team, and that provides real upside in terms of gaining a greater degree of client inquiry to that group of new dealers.

Hugh Miller - *Sidoti & Company - Analyst*

Great. And I guess maybe an area that you didn't spend as much focus on -- the opportunities that you guys are seeing and demand for the financial technology services and so forth. Is there anything that you are kind of seeing strengthening there?

Rick McVey - *MarketAxess Holdings Inc. - Chairman, CEO*

The overall environment, I think as Tony mentioned, appears to be better. And whether you look at earnings from technology companies or you read various letters or surveys in the marketplace. We are seeing some modest improvement and a more regular sales process in our GST business, which, as you know, is the fixed monitoring certification business.

And we are also seeing some demand from our dealer and client group for help in their aggregation of various ECN pricing and evaluating how one could, in a sense, auto quote and perform more efficiently on our platform, especially in the moderately smaller sizes.

So as Tony said, we are cautiously optimistic for our combined tech service and market data business to show improved results throughout the year. But again, it can be very dependent sort of case-by-case in terms of budgets that have been provided, as well as IT priorities. But we do feel like the overall environment seems to be a bit healthier in 2010 versus 2009.

Hugh Miller - *Sidoti & Company - Analyst*

Good, great. And the last question, I guess, you know is something that we always kind of touch base and harp on. But given the strength of the balance sheet -- I know obviously, you have some growth opportunities organically in strengthening the platform. But does it seem as though there looks to be any opportunities on the horizon from an acquisition standpoint? Or if not in that regard, would there be the potential for a dividend raise at some point go forward?

Rick McVey - *MarketAxess Holdings Inc. - Chairman, CEO*

I think we are actively considering all the options for the use of our balance sheet and our cash position. On the acquisition front, we see things in the market virtually every quarter. We've obviously been selective historically because of the confidence that we have in our organic growth prospects. But we do see some things from time to time that would expand our capabilities, especially in the fixed income, E-trading, connectivity and data space. So we expect to see more of those opportunities in 2010, but at the same time, we will be selective because of the momentum that we see in our core business.

With respect to the dividend, this is our third quarter with the regular dividend. The Board will discuss the appropriate level for dividends based on our earnings and cash flow on a quarterly basis. And as we said the first time out with the dividend announcement nine months ago, we thought that something around the area of a third of our free cash flow and a dividend yield of 2% or slightly better was the right area to target.

Hugh Miller - *Sidoti & Company - Analyst*

Okay, great. Thank you very much.

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Operator

(Operator Instructions) Justin Hughes, Philadelphia Financial.

Justin Hughes - Philadelphia Financial - Analyst

Good morning. Thanks for taking my question. The one thing I wanted to dig into a little bit more is on your variable fee rates; if we could just dig into the US high-grade. That was flat year-over-year, but down quite a bit quarter-over-quarter. I'm just kind of wondering what is driving that and what should we expect it to do going forward?

Tony DeLise - MarketAxess Holdings Inc. - CFO

The US high-grade fee capture rate, there are lots of items that impact that rate. From the fourth quarter to the first quarter, the two single biggest items were the shorter average duration of bonds traded on the platform, as well as a lower contribution from our hybrid execution desk.

And you will see, that average duration, it had probably hit all-time highs -- at least over the last five years -- all-time highs during 2009. And it has migrated down slightly in 2010.

The way our fee plan works for high-grade, it is dependent on duration. And also, again, this is the hybrid trading desk. With what has happened in the market, with what has happened with spreads, the contribution from that business is a little lower in the first quarter than it was in the fourth quarter.

Justin Hughes - Philadelphia Financial - Analyst

Okay. And then your market share as a percentage of TRACE dipped down just a little bit, but it is the first kind of drop we've seen in I think about a year. How is that trending in April?

Kelley Millet - MarketAxess Holdings Inc. - President

Let me just comment -- it's Kelley -- briefly on the factors that will influence the short-term market share. First, obviously, is overall market liquidity. The second is buy-side investor flow imbalances, i.e. if the market is offer-wanted or bid-wanted. And the third is the percentage of IDB or interdealer trading as a percent of overall TRACE.

So those factors can influence share by 1/10, 2/10, 3/10, depending on which direction that they move. Although we don't forecast our share number as we are still a week or so away from releasing volumes, in the current environment, we don't see anything that is materially different or out of context in terms of what we saw in the first quarter.

Justin Hughes - Philadelphia Financial - Analyst

Okay, thank you.

Operator

Chris Donat, Sandler O'Neill.

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Chris Donat - Sandler O'Neill - Analyst

Just looking for a little more color on the CDS opportunity, knowing that you're making progress there. But I'm curious a little bit on client demand for it.

And then there have been the advances with the clearinghouses; we've seen ICE's clearinghouse in place for a year. I'm just wondering where you think the market is now -- because it seems like in general the CDS market has been sort of beaten down as far as activity goes -- and if you think it is positioned for a rebound or if it really needs some more regulatory and infrastructure improvements before that market gets robust again.

Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

Sure. Happy to comment on that. I do think the trends in CDS volumes during the course of 2009 were down. But it's important to remember, it is still a very large market, and based on the information that we can collect, we think daily volumes in the CDS market are 5 to 8 times higher than they are in the cash credit markets.

So it is still a very large market. More than half of that volume seems to be taking place in index products, which as you point out, are trending toward more central clearing, which is helping with the safety and soundness of the CDS system overall.

So I think in general, the volumes are still quite high in CDS. And importantly, our view is that as the infrastructure improvements take hold in CDS, with the onset of more central clearing, a sound margining system, daily mark to markets and more transparency in the market, you will see an increase in market participation in that product going forward. And specifically, we believe that more traditional investment managers are likely to participate in CDS and other derivative markets on the back of some of the improvements in infrastructure that are taking place.

Chris Donat - Sandler O'Neill - Analyst

Okay. And as I think about your client base, is it safer to say they skew more toward the traditional side than the hedge fund side?

Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

I think that is a logical conclusion, given that the vast majority of trading that we do today is in cash credit products, which is the domain of the traditional investment managers and insurance companies.

The hedge funds tend to be clients of market access and are signed up for trading. But given that historically most of their volume has been in CDS, they are not today as active as the traditional investment management community.

Chris Donat - Sandler O'Neill - Analyst

Okay. Then just one quick one for Tony here. The comment that the expenses might be at the high end of that \$94 million, just using the first quarter as a run rate, it looks like you are above that level right now. So I guess the implication is out quarters might be a tad lower than the current quarter. It's a simple math, but I just want to confirm that's what I'm looking at.

Tony DeLise - MarketAxess Holdings Inc. - CFO

In the first quarter, we did have \$625,000 of what we'll call one-time costs.



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Chris Donat - Sandler O'Neill - Analyst

Okay, yes.

Tony DeLise - MarketAxess Holdings Inc. - CFO

So if you back that out, there will be some changes in expenses as we progress during the year. But if you back out the \$625,000, it probably gets you back to that run rate at the higher end of that range then.

Chris Donat - Sandler O'Neill - Analyst

Okay, got it. Thanks very much.

Operator

And there are no additional question in queue. I would now like to turn the conference over to Mr. Rick McVey for closing remarks. Sir, you may proceed.

Rick McVey - MarketAxess Holdings Inc. - Chairman, CEO

Thank you for joining us this morning, and we look forward to talking with you again next quarter.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect and have a great day.

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