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# EDITED TRANSCRIPT

MKTX - Q4 2013 MarketAxess Holdings Inc. Earnings Conference Call

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## CONFERENCE CALL PARTICIPANTS

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**Patrick O'Shaughnessy** *Raymond James & Associates - Analyst*

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## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by. (Operator Instructions). As a reminder, this conference is being recorded January 29, 2014.

I would now like to turn the call over to Dave Cresci, Investor Relations Manager at MarketAxess. Please go ahead, sir.

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### Dave Cresci - MarketAxess Holdings Inc. - IR Manager

Good morning, and welcome to the MarketAxess fourth-quarter 2013 conference call. For the call, Rick McVey, Chairman and Chief Executive Officer, will review the highlights for the quarter and will provide an update on trends in our businesses. And then 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 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 on Form 10-K for the year ended December 31, 2012.

I would also direct you to read the 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.

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### Rick McVey - MarketAxess Holdings Inc. - CEO & Chairman

Good morning and thank you for joining us to discuss our fourth-quarter and full-year 2013 results. This morning we reported fourth-quarter revenues of \$60 million, up 24% from the prior year. Pretax income for the quarter increased 12% to \$25 million, and diluted EPS was \$0.41, up from an adjusted \$0.38 a year ago.



Organic growth was driven primarily by increasing market share and market volumes in our core products. US high grade volumes were up 15% from the prior-year quarter.

Expenses were up 35% to \$36 million, reflecting ongoing investments in organic growth and the impact of the Xtrakter acquisition. During the fourth quarter we also reported an accounting gain of \$7.6 million or \$0.20 per share on the sale of Greenline.

We saw growing momentum through the year in our Open Trading initiatives, with increased client and dealer participation and the development of new functionality to facilitate all-to-all trading.

Slide 4 highlights our continued strong growth rates. Annual growth rates for volumes, revenues, and EPS in 2013 were in line with our strong long-term averages, with variable transaction revenues and EPS both up 24% in 2013 compared to 2012, and total revenues up 16%.

Record transaction revenues for the year were driven by market share gains and record volumes across our core products: high grade, high yield, and emerging markets.

Total full-year trading volume of \$694 billion was up 18% over 2012. US high grade estimated share for the year was 13.8%, up from 12.4%. High yield trading was our highest growth area, with estimated market share up more than 200 basis points year over year to 5.2% in 2013.

While no regulatory tape exists for EM, based on available information from EMTA, we estimate that our market share of the EM external debt market also increased by approximately 1 percentage point year over year.

Based in part on these results, our Board approved an increase in our quarterly dividend to \$0.16 per share. In addition, our Board approved a \$35 million share repurchase plan, primarily to offset dilution from stock compensation.

Slide 5 provides an update on market conditions. Combined US high grade and high yield trades volumes for 2013 were up just 5% compared to the prior year. Corporate debt outstanding continued to grow at a healthy pace on the back of record new issuance.

10-year treasury yields rose steadily throughout the year, reaching 3% in the fourth quarter, their highest level since the second quarter of 2011. Meanwhile, credit spreads tightened significantly towards the latter part of the year; and despite continued outflows from taxable bond funds, demand for credit bonds outstripped supply. The current secondary trading environment, featuring strong demand and low dealer inventory, creates challenges for investors seeking to add bonds to their portfolios.

Primary dealer holdings of high grade and high yield bonds ticked up modestly at the end of the year, but remain depressed compared to historical levels, ending the year at \$21 billion, or slightly more than one day of trades volume. With the incoming regulatory capital requirements, we believe that pressure on primary dealer balance sheets will continue, reinforcing the need for new liquidity solutions in the market.

Slide 6 provides information on our progress in Open Trading. Our high grade market share gains were more modest in the fourth quarter than long-term averages. While bid-wanted hit rates were healthy at 85%, offer-wanted hit rates declined due to the supply/demand imbalance.

Market turnover of outstanding corporate debt remains at levels equivalent to the lows seen during the credit crisis of 2008, reflecting the ongoing liquidity challenge in the bond markets. If US high grade bond turnover returned to a long-term average of around 1 time per year, trades volume would be almost 50% higher than 2013 levels.

We continue to believe that connecting our dealer and investor participants through a range of innovative trading protocols will help to improve overall liquidity and turnover in credit products. In the fourth quarter 75% of investor inquiries were sent to the Market Lists open order book compared to 40% in the prior-year quarter. Over the course of 2013 over \$600 billion in live orders were available on Market Lists, resulting in over 14,000 open trades among system participants.

Recent Open Trading enhancements expand Market Lists for dealer-initiated bid and offer list orders; improved order matching alerts to system participants; and ad protocols designed to address larger trade sizes. With three trading days remaining in January, we currently expect high grade market share to be modestly below the fourth-quarter average and well above last January.

Slide 7 provides an update on SEF regulations. Since the implementation of SEF rules in early October for permitted transaction, the industry has seen a rapid decline in the electronic trading of swaps. We currently estimate that less than 10% of CDS index trading is taking place on SEFs.

Electronic CDS volume on MarketAxess was up over 100% in the first three quarters of 2013 versus the prior year, but fell 80% after SEF rules were implemented in October. The highly prescriptive CFTC SEF rules create documentation, counterparty credit, trade execution, and clearing challenges for industry participants. As a result, most swap trading is currently conducted away from SEFs in the short term.

The CFTC made available at trade determinations have been finalized for on-the-run CDS indices, and mandated SEF trading will begin in late February. At that time, mass CDS index trades below the block-trading threshold will be required to trade on SEFs rather than permitted to trade on SEFs. We estimate that approximately 75% of CDS index trades and 50% of CDS index volume will fall below the block trading exemption and will be subject to SEF trading requirements.

Slide 8 provides an update on Europe. We continue to make progress with our European strategy to develop a comprehensive solution for trade execution, data, and post-trade services. In the last couple of months we have started to see the impact of renewed claim engagement, with a 30% increase in trading volumes from European clients in December and January compared to the same period a year earlier.

We are further expanding our suite of data products to enhance transparency in European fixed-income markets, consistent with the upcoming MiFID II regulatory requirements. We are also investing in broad transaction reporting services for dealers and investors in order to comply with upcoming MiFID II and EMIR regulations.

We expect Xtrakter's business to be accretive to earnings beginning in the second half of 2014, as our investments in technology and new product development begin to drive an increase in revenues and operating margins.

Now I would like to hand the call over to Tony for additional details on our volumes and financial results.

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**Tony DeLise** - MarketAxess Holdings Inc. - CFO

Thank you, Rick. Please turn to Slide 9 for a summary of our trading volume across product categories.

Our overall global trading volumes were up 15% year over year to \$171 billion. US high grade volumes were \$106 billion for the quarter, also up 15% year over year. Lower offer-wanted hit rates coupled with order flow favoring the offer side combined to reduce our market share gains in the fourth quarter.

Volumes in the other credit category were up 13% compared to the fourth quarter of 2012. Year-over-year market share gains in high yield were the primary driver of the other credit category improvement.

Slide 10 displays our quarterly earnings performance from continuing operations. Revenues of \$60.4 million were up 24% from a year ago, principally due to a 14% increase in trading commissions and the inclusion of Xtrakter's post-acquisition results.

Total expenses were \$35.7 million, up 35% from the fourth quarter of 2012. Excluding the Xtrakter operating expenses, total expenses were up 9% year over year and reflect the ongoing investments in people and technology to support Open Trading, CDF, and other initiatives.

Our diluted EPS was \$0.41 compared to an adjusted \$0.38 per share one year ago. For comparative purposes, the fourth-quarter 2012 tax provision has been adjusted to exclude a nonrecurring favorable income tax adjustment of \$6.7 million, or \$0.18 per share related to certain acquired tax loss carryforwards.

On Slide 11 we have laid out our commission revenue trading volumes in fees per million. The 15% year-over-year improvement in variable transaction fees was due entirely to the increase in overall trading volumes.

US high grade fees per million were \$184 in the fourth quarter, down \$8 per million from the third quarter. As mentioned on the third-quarter earnings call, one dealer migrated from the all-variable high grade plan to the major plan during the third quarter, and a second dealer followed the same path on October 1.

As a reminder, dealer movement in this direction typically results in the increase in distribution fees and an offsetting decrease in variable transaction fees. At current volume levels, a single dealer migration impacts fees per million by roughly \$5.

Fees per million in the other credit category were \$321 in the fourth quarter, up from \$291 a year ago and from \$317 in the third quarter. The year-over-year improvement is due to trading mix favoring high yield volume. Similar to the third quarter, emerging market and high yield volume accounted for approximately 85% of the other credit category volume.

Distribution fees were \$16.1 million during the fourth quarter. We currently expect that first-quarter 2014 distribution fees will be similar to the fourth-quarter level.

Slide 12 provides you with the expense detail. Fourth-quarter 2013 expenses were \$35.6 million, up 3% sequentially from the third quarter. The fourth quarter and full-year 2013 expenses were right at the midpoint of the updated guidance we provided on the third-quarter earnings call.

The sequential decline in employee compensation and benefits was almost entirely due to lower variable incentive compensation. And the sequential increase in depreciation and amortization is largely attributable to our replacement primary production data center coming online late in the third quarter.

During the fourth quarter we consolidated office space in London and sublet the legacy MarketAxess location. Fourth-quarter 2013 expenses include a loss on a sublease and duplicate rent, totaling approximately \$600,000.

On Slide 13 we provide balance sheet information. Cash and securities available for sale as of December 31 were \$200 million compared to \$180 million at year-end 2012.

During 2013 we expended approximately \$38 million to acquire Xtrakter, paid cash dividends totaling \$20 million, and spent \$23 million on capital expenditures. Cash flow from operating activities generated during 2013 of \$91 million were more than sufficient to cover the investments and capital return.

There was no change in our capital structure during the fourth quarter. We have no bank debt outstanding and didn't borrow against our revolving credit facility.

On Slide 14 we summarize our capital management activities. Our recurring quarterly dividend remains an active part of our capital management priorities. With the announced increase to \$0.16 per share, we have now increased the quarterly dividend in four consecutive years. We have also increased our investment in Open Trading, CDS data, and other organic initiatives, including several new data center buildouts. We expect these investments to help drive future revenue growth.

Today we also announced a \$35 million share repurchase program. Since the date of our last major repurchase in connection with the JPMorgan secondary offering in February 2012, our diluted share count has increased by almost 700,000 shares. The purpose of this new program will primarily be to offset the increase in our diluted share count, principally resulting from annual equity grants. We expect the program to go live later in the first quarter.

We remain focused on capital management and investment in organic initiatives. Through our existing cash position, strong cash flow generation, and line of credit borrowing capacity, we have the flexibility to meet our capital management and investing priorities.



On Slide 15 we have laid out our 2014 expense, capital expenditure, and income tax rate guidance. We expect that total 2014 expenses will be in the range of \$150 million to \$157 million. The midpoint in that range suggests an approximate 9% increase in expenses over the second half of 2013 run rate. Employee compensation and benefit costs are expected to represent a little over 50% of total expenses, consistent with the trend over the past several years. The increase in depreciation and amortization reflect the higher level of capital expenditures in 2013 and 2014.

We expect another heavy year of investment in 2014 and estimate that capital expenditures will be between \$17 million and \$20 million, split about evenly between software development and IT-related equipment and software.

We expect the effective tax rate for full-year 2014 will be between 37% and 40%. After adjusting for one-time items, the effective tax rate in both 2012 and 2013 was approximately 38%. Among other items the mix of US and foreign-source income and change in tax rates could cause variations in the effective tax rate.

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

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

Thanks, Tony. 2013 was another strong of growth for our core business in high grade, high yield, and EM. Our dealer and investor clients continue to embrace electronic trading for a growing percentage of their credit trading activity.

Regulatory changes create new opportunities for Open Trading, transaction reporting, CDS, and data products. We are pleased with our progress to expand our service offering in these large and important areas for our clients. The combination of market-driven demand and regulatory change creates an attractive environment for growth for the Company, and we are excited about the opportunities ahead in 2014 and beyond.

Now I would be happy to open the line for your questions.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Ashley Serrao, Credit Suisse.

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**Ashley Serrao** - Credit Suisse - Analyst

Rick, it feels like two of the key hurdles for further buy-side engagement in all-to-all trading are maybe obtaining reliable reference prices to price bonds, and then compliance systems that are designed for price takers. So I was hoping you could share some color on year current real-time conversations with clients here, and also your thoughts on the timeline for these two elements to evolve?

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

Absolutely. Real-time price data is a core ingredient of moving toward a more open architecture. And the move by regulators to promote transparency certainly helps with the trades tape here in the US and the MiFID II consolidated tape planned in a couple of years.

So there is more transaction data out there. And then you see analytical services and companies continuing to add pricing capabilities in real time to expand beyond the set of reported bonds. And we're working with IDC and importing prices from other service providers to help investors with that task, and we will continue to do so as those analytical capabilities continue to advance.



I think your second question relates to best execution requirements. And you're right to point out that many of the investor best execution guidelines are antiquated for moving into an environment of all-to-all trading, because in many cases the guideline reflects getting three or more dealer prices. And we do see some movement in that.

And by the way, this is not an SEC restriction. The SEC provides plenty of room for investor judgment on best execution. It's just the default that many investors have used in the past. So we do see some progress there with investors using independent pricing from other sources as a means of demonstrating best execution. And I don't think that that will be a meaningful obstacle in the progress on Open Trading.

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**Ashley Serrao** - *Credit Suisse - Analyst*

Thanks for all the color there. And switching to expenses, I thought it was a meaningful ramp-up this year.

Maybe you can share some color on the revenue side. I presume Xtrakter will play a key role there. So any color on what is low hanging fruit, what is more aspirational? And just how you are thinking about the revenue side of the equation in general would be appreciated. Thank you.

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

And that is specific to Xtrakter, Ashley?

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**Ashley Serrao** - *Credit Suisse - Analyst*

Yes, Xtrakter and otherwise as well.

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

With respect to Xtrakter, no real change there in the strategy and the growth expectations. The revenue growth really, we think, comes from two primary areas. One, continuing to develop and distribute high-quality data products. And we have been working both internally to develop those products as well as with our dealer-investor clients to make sure that we are promoting volume and price information in a way that is constructive to the market and helpful to liquidity.

And the other area is continuing to expand our post-trade services and especially around transaction reporting and trade matching. And the transaction reporting requirement in the past has been limited to the dealer community. It is now moving out to the investment management industry, and we are expanding our services to be able to help those clients with transaction reporting. And we also see more opportunities to use the data we have within Xtrakter to report real-time trade matching.

So those three main areas really drive most of what we expect in the revenue increase that lead to the comments that we made earlier about our hope that Xtrakter will be accretive to earnings in the second half of this year. And all of that is consistent, we also think, with our core mission of also developing a broader electronic trading market in Europe.

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**Operator**

Jillian Miller, BMO.

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**Jillian Miller** - BMO Capital Markets - Analyst

Sticking with the Europe topic, I think you mentioned that the trading was up, like, 30% year on year in January. And I was just wondering: how much of that is related to share gains because of some of this better data versus just general market strength?

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**Tony DeLise** - MarketAxess Holdings Inc. - CFO

Jillian, we don't think it is on -- those volume improvements are coming on the back of increase in trading and overall market trading volume. We do have some increase visibility on trading volume coming out of Europe, and we think it is probably half of the trading volume you see here in terms of high-grade trade volume. But we don't think it's on the back of the improved overall market volumes.

And Rick's comments were sort of a combination of both December and January. So it wasn't just for the one-month period.

And just important to know -- when we talk about volumes coming from our European clients, it's not just euro bond volumes. Our European clients are very active in emerging markets, high grade in particular. So those volume improvements are across multiple products, including what we consider North America credit trading products.

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**Jillian Miller** - BMO Capital Markets - Analyst

Got it. So it is not euro bonds that are up 30%; it's trading from European clients that is up 30%.

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**Tony DeLise** - MarketAxess Holdings Inc. - CFO

Correct.

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**Jillian Miller** - BMO Capital Markets - Analyst

Okay, got it. And then I just wanted to confirm. The US high grade fee rate compression -- am I interpreting your comments right that that was related to the dealer migration to that new plan versus anything going on with the yield curve or other factors?

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

Jillian, if you look at sequential quarters, third quarter to the fourth quarter, it is -- almost 100% of that variance, that \$8 per million, was the migration of the dealers. And I mentioned in the prepared remarks, when we have -- all things equal, one dealer migrating in that direction that happened, which was going from the all-variable plan to the fixed plan, it is roughly \$5 per million in variable fees. Neutral to overall revenues, but \$5 per million in variable fees.

It's a little more complicated when you get the comparisons from the fourth quarter of last year, 2012 to fourth quarter of 2013. There's a lot more noise in there. We have -- dealer migration would have been a negative to fee capture. But we have interest rates rising; all things equal, that is a negative.

We had longer duration, which would have been positive. And also, another positive -- this is year over year again -- our dealers on the all-variable plan, they continue to win more trades. So that's a little more complicated year over year. It is easier to explain sequential third quarter to fourth quarter.

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**Jillian Miller** - *BMO Capital Markets - Analyst*

Got it. And then on capital, the amount that you guys want to hold on the balance sheet is in flux in the moment, from what I understand, just because you are acting more often as riskless principle on the all-to-all transactions.

So maybe you can fill us in on what your plans on there. How much cash do you feel like you need to hold based on what you're doing currently? And then if you've made any decisions with respect to whether you will look to outsource that kind of middleman position to dealers, eventually, or if it's something you think you can monetize and want to keep doing?

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

On the first question, we are very comfortable with our capital position, even with the return of capital that we have outlined this morning, and the increased dividend in the new share repurchase plan. So we are in very good shape for the kind of business and the amount of business that we are clearing and should be for the foreseeable future.

We are really, like most things, taking on a lead from clients in terms of how they would like to clear open trades. And we have a variety of solutions available to them, both through us and also through traditional dealer counterparties. So it is difficult to predict how that will play out during the coming year or two. But right now we're very comfortable with our balance sheet position, given the amount of clearing that we expect to do.

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**Jillian Miller** - *BMO Capital Markets - Analyst*

And then just one final numbers question. The loss on the sublease: is that a one-time thing, or should we expect occupancy expense to say elevated?

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**Tony DeLise** - *MarketAxess Holdings Inc. - CFO*

So, Jillian, that loss on the sublease and the duplicate rent element of it as well, those are one time. So we exited the legacy MarketAxess space. We exited some Euroclear facilities that Xtrakter was occupying. We leased new office space. We moved in right in the middle of the fourth quarter. That sublease charge is a one-time charge.

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**Operator**

Patrick O'Shaughnessy, Raymond James.

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**Patrick O'Shaughnessy** - *Raymond James & Associates - Analyst*

My first question is: obviously, one of your better growth stories has been high-yield corporate bonds. And I am looking at the industry-wide volumes in high yield, and they have been pretty lackluster. And even though we've seen investment grade really bounce back so far in January, high yield really hasn't. So can you talk about the industry dynamics that are taking place with high yield, such that the trading volumes there aren't as robust as what we have seen over the past year?

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

When you look at the combination of high grade and high yield, you might get a better read, Patrick. And that is where, I mentioned earlier in the call, for the full year in 2013 the combined volume was up about 5% or so.

Part of the reason is through upgrades, where certain large high-yield issuers have now moved up to investment grade. So that is a piece of the story. But I do think that you are seeing a slight increase overall in trades volumes when you look across the two product areas.

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**Patrick O'Shaughnessy** - *Raymond James & Associates - Analyst*

Okay, that's fair. And then moving on to CDS, a couple of days ago InterContinental Exchange put out a press release about a CDS trading platform that they are going to have. And they are going to have three dealers, I believe, streaming quotes. Can you talk about just how do you feel about the liquidity providers to your CDS offering, and how you think that what you are going to offer is going to stack up to some of the other ventures that are out there?

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

Sure. I think developments in the electronic CDS market continue, and different approaches and different models out there, as you would expect. I could be wrong, but I don't think the ICE announcement necessarily said they had three dealers streaming quotes. I think they said three dealers participating. And one of those dealers talked about their role as agent for bringing clients onto the platform as supposed to principal for market-making.

So we're really pleased with the progress that we have made on our own central limit order book. And we have a great partner to begin with in Barclays, who continues to expand the markets that they make on the platform and is onboarding more and more end clients each month. And we and Barclays both remain open-minded about expanding the platform with more investors in more dealers at the right time.

We're very pleased with the progress that we are making on the platform. And obviously, one of the big benefits that we have is all of the bi-side connectivity that already exists here.

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**Patrick O'Shaughnessy** - *Raymond James & Associates - Analyst*

That's helpful. Thanks. And the last question for me: as we were talking about Xtrakter and becoming accretive in the back half of this year, does that imply that you have already begun the sales process for some of these Xtrakter products that you are going to be rolling out? Because presumably, the sales cycle there is going to be at least a few quarters, right?

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**Tony DeLise** - *MarketAxess Holdings Inc. - CFO*

It will be, Patrick. And Rick had mentioned in some of his remarks that we are active out there. We are rolling out new products. We're in front of clients right now. And this is both on the data side and some of the new trade reporting services.

And the other side of the equation on the margin side, or incremental to margins, is the expense side. We're pretty much there in terms of ramping up -- the ramp-up we experienced in 2013 and the Xtrakter-related expenses. If you looked at the expenses for the fourth quarter, there was some comment in the earnings release around fourth-quarter Xtrakter expenses. That is probably pretty representative of the expense run rate for Xtrakter in 2014.

So that is the combination of expenses leveling off; then as we ramp up on the revenue side and the data and both the trade reporting side, that is when we think we can get to this accretive situation in the second half of 2014.

And just one other element to bear in mind: when we talked about accretion, we're also absorbing the amortization of intangible assets created on the acquisition. So when you go through purchase accounting, you allocate the purchase price, the various assets you are acquiring. One of the elements are intangible assets.

That overhead or overhang for the amortization of intangibles is about \$2.5 million. So we are including that when we say that we expect Xtrakter to be accretive beginning in the second half of the year.

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**Operator**

Hugh Miller, Sidoti.

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**Hugh Miller - Sidoti & Company - Analyst**

I had a question following up on the CDS trading opportunity and those questions that you have previously answered. Given how close we are to the commencing of that trading, can you just talk about what you guys are expecting with regards to pricing, and anything you are hearing on the price and competition side?

And then as we think about the single-name trading aspect and that opportunity, if there's anything more that you are hearing out of the SEC about making some headway there on rules?

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

I think pricing still is an open question. I can tell you firsthand, and I'm sure every other SEF would say the same thing -- the expenses are very real. So one would expect that as we get through the finalization of the rules that there would be sensible pricing and revenue models that begin to emerge in the SEF space.

And we would expect at the beginning of the second quarter we would have a modest revenue event from our CDS index activities. So I do think we will probably see some changes around pricing coming up in the next several months.

I'm sorry, the second question, Hugh, was --?

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**Hugh Miller - Sidoti & Company - Analyst**

Just with regards to the SEC and progress with single-name trading and rules there, and your expectations as we look at 2014.

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

We really haven't heard anything at all from the SEC with respect to their timetable on single names. They obviously have a full plate, but we're not aware of anything that has been publicly stated by the SEC in terms of when they would expect to get to their rules.

So our plan for 2014 is really about building out the organic single-name CDS trading platforms. And we do not expect to have any significant regulatory change throughout this year.

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**Hugh Miller - Sidoti & Company - Analyst**

And as you talk about the expense guidance that you have given out, I guess the midpoint coming in a touch higher than what we were looking for, and a little bit higher -- you guys were talking about a high single-digit rate off of the second half of 2013, which was a bit elevated. But can you just give us a sense of what is driving a little bit more of that expense growth? Is it more the Xtrakter deal? Is it investment for CDS? Is that the Open Trading protocols?

**Tony DeLise** - *MarketAxess Holdings Inc. - CFO*

We thought the second half was a better comparison or a better jumping-off point to compare to 2014. We stated about a 9% increase at the midpoint.

And when you look at the biggest expected increases, as you would expect, it is in employee compensation and benefit. It's a little over 50% of where we have been in terms of total expenses. The expectation -- if we are fully staffed up based on our plans, the expectation is headcount would be up another 10%-plus over what you see at year end.

And the areas where we are adding people are the areas you would expect we'd be adding people. It is in technology and sales-related areas, and it's around the new initiatives. So it is exactly where you expect it to happen.

Quite frankly, I think the -- after reading some of the notes this morning and looking back at the estimates for next year, I think one area where you are all playing catch-up on is in the depreciation and amortization area.

We will have -- if we hit that CapEx plan for 2014, \$17 million to \$20 million or thereabout, we will have spent over \$50 million on CapEx in the past three years. 2012, 2013, 2014, over \$50 million. I think when you revisit your models, you're going to see that it is the depreciation area where you are going to play little bit of catch-up.

Outside of employee compensation and benefit, account driven; outside of depreciation and amortization, driven by CapEx spending. If you look at all of the other expense categories -- and what we are inferring from that is that it is largely inflationary-type increases in those other expense categories, outside of comp and benefits and depreciation and amortization.

**Hugh Miller** - *Sidoti & Company - Analyst*

Okay. That is very helpful.

And switching gears, as we think about your efforts with Open Trading and some of the advances you made there this year in 2013, or last year in 2013 as we head into 2014, should we still be thinking about growth in market share similar to the grinding it out that we have seen in prior years, with a couple of hundred basis point rise in market share? Or do you anticipate that this could be the year you start to see an inflection point with share growth?

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

We are ramping up our investments, Hugh, because we expect an acceleration in the electronic share at some point. And our views are shared broadly by the industry and by the various analysts that cover our industry, when you look at the projections that are out there for the likely electronic share in credit over the next two to three years.

It is very difficult to anticipate the pace of share gain, especially given that Open Trading is brand new and involves a fairly significant change in trading process for investors, and dealers, and other market participants. But clearly, whether you look at bonds or swaps or even Xtrakter, we are investing heavily, because we think electronic solutions and connectivity and post-trade services are going to be a much larger part of the market environment over the next three years.

**Hugh Miller** - *Sidoti & Company - Analyst*

And have you started to see any kind of change in the institutional clients you are working with, and their willingness to become more of a market maker as opposed to just take a price from the dealers, and changing the way that they go about investing?

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

Well, I would take issue with the term market maker. We don't see any of them that want to be in the market-making business. Are we seeing a change in behavior in terms of being willing to lead with a price when they see a potential match in the system? We absolutely are.

So we are delivering an awful lot of trade opportunities through Market Lists every day. And the solutions that we have to increase the sophistication of the alerts that our investors are getting continue to grow each quarter. And with that combination, yes, we are seeing a significant ramp-up in the price is back in Market Lists orders, which is leading to the growth in trades.

So that behavioral change is still in the first inning, but it is underway. But in no way do we see any investors that are trying to directly compete with the market-making business; but they are starting to change their behavior so that they can respond to a price when they have a trade match.

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**Hugh Miller** - *Sidoti & Company - Analyst*

Sure. Certainly understood -- I apologize for the terminology of that was used with market-making. But that is what I meant, was a change in their behavior, and willing to go out there and lead with price. But anyway, I thank you for the insight there. Very helpful.

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**Operator**

Mike Adams, Sandler O'Neill.

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**Mike Adams** - *Sandler O'Neill & Partners - Analyst*

A couple of questions here. One on the market share in high yield. Appreciate the disclosures you added to the deck this quarter, but could you give us a sense for the high yield quarterly market share trends, maybe exiting the year? Was that above the overall full-year market share of 5.2%?

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**Tony DeLise** - *MarketAxess Holdings Inc. - CFO*

Mike, it was slightly above the average for the year. And if you look at it year over year -- and I will just give you one data point, would be for the fourth quarter: it was up about 200 basis points year over year in the fourth quarter. And that ramp-up happened throughout the year. It did peak. Similar to high grade market share, and it did peak in the third quarter. But there was a ramp throughout the year.

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**Mike Adams** - *Sandler O'Neill & Partners - Analyst*

And then, Tony, following up on some of your comments on the buyback, it sounds like it's not really offsetting future dilution; it's actually going to be playing a little bit of catch-up on some of the share dilution we saw in 2013. Is that the right way to think about it? So that diluted share count should come down over the course of the year?

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**Tony DeLise** - *MarketAxess Holdings Inc. - CFO*

Yes, Mike, I think that is the way to look at it. And this is a new program that the Board adopted. We said it was to offset the increase in the diluted share count. It has crept up in the last seven quarters now.

We're going to set up a -- it's sort of a maintenance-type program. We're going to set up a 10b5-1 plan. We will be in the market for a small amount of repurchases each day. It really wasn't meant to be this large, opportunistic buy.



We obviously have a capacity to do something if the opportunity presents itself. But think of it more as a maintenance program, and think about us being in the market throughout the year. It's not -- and you can do the math -- it's not a big program. At today's price it is roughly 600,000 shares. If we are in the market accordance with this 10b5-1 program, it is probably in the course of a year where we have exhausted the program.

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**Mike Adams** - *Sandler O'Neill & Partners - Analyst*

Got it. That's it, guys, thanks. Congrats again.

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**Operator**

Niamh Alexander, KBW.

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**Niamh Alexander** - *Keefe, Bruyette & Woods - Analyst*

If we could talk a little bit about the fourth quarter, just on the high grades -- sort of a big revenue line fee, an important earnings driver. How do we think about maybe why the market share peaked? Usually we are used to seeing a bit of a spike in the fourth quarter, and then market share comes off typically in the first quarter, because there's so much issuance, and the primaries get it. So what can you share there about maybe the market share dropping off a bit in the fourth quarter? And what can you share about January so far?

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

You are right. On the fourth quarter -- we are reporting volumes every month. You see the market share; you see the trades volumes. In fourth quarter market share was down about 100 basis points over the third quarter, up slightly from the fourth quarter of last year.

Honestly, it sort of bucked the historical trend here. It is rare where we would see that sort of decline from the third quarter to the fourth quarter. But when we look at market share, we always say it is a function of client order flow and hit rate. But when you get more granular, it is the mix of flow between the bid and offer. It is hit rates on the bid side; it is hit rates on the offer side; it is new issuance; block trades. There's a lot of other elements in between it.

We finished up four consecutive quarters, ending with the third quarter, where we had flow favoring the bid side. And we had a healthier offer side hit rate. We move into the fourth quarter, where we had the sort of inverse happen, where we have flow favoring the offer side; and then we had hit rates on the offer side which were extremely low.

And we have had pockets like this before. If you look back at October of 2012, you are going to see a similar situation. If you look back at beginning in 2009, when the market was turning and it was very much an offer-wanted market, you will see that same kind of experience.

I will give you just one other data point here. If you look at December -- and December was a very good month for us. It was 15.4% market share. It was a good month.

It could have been better. We had a lot of inquiry flow coming in, but we had a situation with very heavy offer-wanted. We had -- the offer side hit rate was down to crisis levels, below 50%. So as good as it was in December, it was still a challenging environment for us. So this gets back to some of the comments that Rick made earlier about providing solutions to help with these liquidity challenges.

We went through a pocket just now in the fourth quarter. It was hard to dig out of that October/November situation with the offer-wanted, lower offer-wanted hit rates. Hard to dig out of that one.



And when we come to January now, Rick did make a comment that January share right now is modestly below the fourth-quarter level. Typically in January --

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**Niamh Alexander** - Keefe, Bruyette & Woods - Analyst

Typically (inaudible) is not high yield, right?

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

For high grade, correct. And typically you will see pretty dramatic decline. It's probably a 100 basis point decline between the fourth quarter and January. So the view we are giving you, or this early read on January, suggests that you're not going to see that type of typical decline there.

But the market is a little bit different here in January. It is more of a bid-wanted market. Hit rates haven't changed, but the market has turned a little bit in terms of the order flow.

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**Niamh Alexander** - Keefe, Bruyette & Woods - Analyst

Okay. That's helpful. Thanks, Tony.

And then the high yield and the emerging markets: can you talk a little bit about the current environment? Because with the emerging markets already -- I guess middle of last year, the big challenge in the industry was, I guess, the offer-wanted again. It clearly kind of dried up. And you were one of the few electronic venues people turned to.

So what can you share about the current environment? Are you seeing a lot more similar kind of trends, like a lot of people trying to sell? Or are you seeing better hit rates in those particular markets right now?

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

The EM environment is definitely choppier than the US high grade or high yield environment. There is political unrest. There's concerns about growth rates, and the markets that have just been more volatile and choppy.

And that -- the best proxy we have is looking at EMTA volumes that are released quarterly, and a portion of EM corporates come through on TRACE. And it did look like the second-half market volumes came off in EM relative to what we saw in high grade and high yield. But these are all estimates based on the best information that we can get.

So the overall environment is not quite as healthy as it is in high grade and high yield. But the good news is the EM is consistent with the other product areas, and that everything that we could tell, we continue to gain share.

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**Niamh Alexander** - Keefe, Bruyette & Woods - Analyst

Thanks, Rick. And then just lastly, if I could -- and Tony, you said we all kind of have to catch up on the D&A. I guess we just didn't know when all this CapEx was going to translate to the revenue generation phase, where you were going to start accruing the D&A.

Can you guide me to -- maybe it is just geography, but you are already saying, like, Xtrakter should be accretive second half. Which areas should we be looking for to build up the revenue? Because we expect higher revenue with the higher expenses, I mean -- investment payback. Is it the information, post-trade services where we should look for more of that? Or is it the technology? Or is it more -- you're expecting more on the trading side?



**Tony DeLise** - *MarketAxess Holdings Inc. - CFO*

We really don't give the guidance around the revenue expectation, but I will try to give you a couple of data points and help you zero in a little bit. The revenue growth for next year will not come from the tech services line. That's a small piece of what we're doing. It's less than 3% of our revenue. That is not where the growth is going to come from.

There are expectations on that information and post-trade services line, as Rick has mentioned a couple of times, around growing data revenues and post-trade services. There is some expectations of revenue growth there. You're going to see growth on that line year over year, just by virtue of the fact that Xtrakter is in there for 12 months. But over and above that, that 12-month adjustment -- there is some expectation of revenue growth there.

And you know what drives our business. What drives our business is market share gains. And we've got that one big line there for commission revenue.

So when you are doing your modeling, just like we do our modeling here, it is still very much a commission-driven outcome. So it will come from that commission line, some contribution from information and post-trade services. And then the tech service line, I would say, a small piece of what we're doing.

**Niamh Alexander** - *Keefe, Bruyette & Woods - Analyst*

That's helpful. And then just lastly, if I could, with respect to Open Trading and all, especially the level of integration to the order management systems -- we're really interested in that aspect. And as you roll it out to more desks, help me understand. Are there a few big clients still to catch there? What can you share -- not the names, obviously, but maybe in terms of timing, how that progress -- how you are making progress there.

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

Sure. An important piece, because trading efficiency and connectivity we think is a key part of being successful in Open Trading. And as you know, we have been doing a lot of work with Blackrock Aladdin around system integration for Blackrock and the other Aladdin clients, which total about 60 investment management firms.

And it is really compelling to see how trading efficiency has improved for Aladdin clients with the integration of Market Lists orders into the Aladdin order blotters to make it easier for those clients to identify potential trade matches and provide a price on Market Lists inquiries.

So we're very pleased with that. Blackrock has been true to their word and being very focused on Aladdin integration and improved efficiency for Aladdin clients. They have also been leading the pack with respect to trading activity and order flow in the Market Lists. So we are very pleased there.

But we are consistently finding new ways that we can also increase that level of efficiency for clients beyond Aladdin. So the ecosystem is growing so that the technology can really be much more relevant to clients in terms of the way that we display trade opportunities to them throughout the trading day.

So this is a key part of what we're investing in. And we've made a lot of progress in the fourth quarter, especially with Blackrock Aladdin. And more to come in 2014.

**Operator**

(Operator Instructions) Michael Wong, Morningstar.





**Michael Wong** - Morningstar - Analyst

Are there one-time projects in the 2014 CapEx budget, or is this a fairly normal level going forward?

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

That is a good question, Michael. I would say, certainly, both 2013 and 2014 -- I wouldn't call that the normal run rate or normal maintenance run rate for CapEx.

Right now there is at least one discrete area, and that is in Europe. Today we still reside within the Euroclear data centers, which is part of the acquisition. So our technology environment is within the Euroclear data centers. We will be moving out of those data centers. So there are some -- what I would call not necessarily one time, but big, chunky costs that won't recur every year. That is one element.

But looking at it a different way, if you think about what the maintenance -- longer-term view, maintenance CapEx would be, it is -- I am going to give you a pretty big range, but it's probably more like \$10 million to \$15 million. And we're still spending a lot on product enhancements, on software development. You could see those numbers. And we're pretty transparent about those numbers.

It has been sort of in that \$7 million, or \$8 million, or \$9 million range. And then you tack on top of that maintenance CapEx, and that is, say, \$2 million to \$5 million. And you add them together and you get \$10 million to \$15 million. So that is probably the longer-term view. And again, 2013 and 2014 would have some chunky items in there.

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**Michael Wong** - Morningstar - Analyst

And can you talk a little bit about permissioning, or who has the ability to see or execute orders on your staff?

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

Sure. There are impartial access rules within the SEF rules that require that any participant on the SEF be in a position where they could both send and receive orders. So our SEF does operate in that way.

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**Michael Wong** - Morningstar - Analyst

Okay. And just a really quick one. With changing interest rate expectations, you have seen some increase in volume trade for floating-rate debt. I know it has a low variable fee per million. But do you still expect that to climb from here, or is it more or less as high as you think it will go?

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

I think as expectations grow in a rising interest rate environment, it would be reasonable to expect that the interest in floating-rate notes will grow. We do report them separately, because the fee capture, as you point out, is very different, so that you can track growth in fixed-rate business separate and apart from floating-rate business.

But overall, we think a rising interest rate environment is going to make the trading opportunities much more interesting in credit. And we had a little snapshot of that in June last year, which happened to be our largest month of the year in terms of share and volume. So we actually think that the environment overall for trades, volume, and market activity will be better in a rising rate environment.

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**Michael Wong** - Morningstar - Analyst

Okay, thank you.

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**Operator**

Thank you. And I am not showing any further questions at this time. I would now like to turn the call back to Rick McVey for any further remarks.

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

Thank you for joining us this morning, and we look forward to catching up next quarter.

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**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.

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