THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

MKTX - Q4 2016 Marketaxess Holdings Inc Earnings Call

EVENT DATE/TIME: JANUARY 25, 2017 / 3:00PM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Dave Cresci *MarketAxess Holdings, Inc. - IR Manager*

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

Tony DeLise *MarketAxess Holdings, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

Patrick O'Shaughnessy *Raymond James & Associates, Inc. - Analyst*

Kyle Voigt *Keefe, Bruyette & Woods, Inc. - Analyst*

Conor Fitzgerald *Goldman Sachs - Analyst*

Chris Shutler *William Blair & Company - Analyst*

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

Hugh Miller *Macquarie Research - Analyst*

PRESENTATION

Operator

(technical difficulty) later we will conduct a question-and-answer session. (Operator Instructions). As a reminder, this conference call is being recorded January 25, 2017. I would now like to turn the call over to Dave Cresci, Investor Relations Manager at MarketAxess. Please go ahead, sir.

Dave Cresci - *MarketAxess Holdings, Inc. - IR Manager*

Good morning and welcome to the MarketAxess fourth-quarter 2016 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, 2016. I would also direct you to read the forward-looking statement disclaimer 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. - CEO, Chairman*

Good morning and thank you for joining us for the fourth-quarter and full-year earnings call.

Fourth-quarter trading volumes matched the record levels of the second quarter and were up 35% year over year. Quarterly average daily volume records were set in US high-grade, emerging markets, and Eurobonds. This is an extraordinary outcome, given the normal seasonal factors impacting the quarter. A combination of strong market volume growth post the US election and continued gains in market share contributed to the results.

On the back of the growth in trading volumes, revenues for the quarter were $94.4 million, up 23%. Pretax income of $50 million was up 36% and EPS equaled our record quarter at $0.88 per share.

Based on our estimates of market volumes during the quarter, combined aggregate market share of our core products, including high-grade, high-yield, emerging markets, and euros, reached a new record high during the quarter and was up a full 2 percentage points from year-ago levels.

Slide 4 highlights our full-year results and continued strong growth rates. Revenue and earnings growth for the full year in 2016 shows an acceleration of our long-term growth rates. Full-year 2016 revenue was a record $370 million, up 22% from 2015, and diluted EPS was up 31% to a record $3.34 per share. Both revenue and earnings growth in 2016 were well above long-term growth rates.

Commission revenue for 2016 was up 25% year over year to a record $332 million, as overall trading volumes reached a record $1.3 trillion, up 34%. We are beginning to see returns from the increased investment in both our US and our international business.

We estimate that the five-year compound annual growth rate for aggregate market volumes across our core four products was 1%. Comparatively, our trading volumes show a five-year compound annual growth rate of 20%. This means that market-share gains continue to be the primary driver of volume and revenue growth.

In light of our strong results and our outlook, the Board of Directors approved a 27% increase in the regular quarterly dividend to $0.33 per share.

Slide 5 shows our volume and client growth by product. Our year-over-year volume gain of approximately $330 billion was by far our largest ever. The growth in trading activity was driven by share gains with existing clients, as well as the ongoing addition of new clients. Combined US high-grade and high-yield volume of $879 billion was up 27% from 2015. We now have approximately 900 client firms active in these product areas.

We are especially encouraged by the growing momentum in our international business, with both emerging market and Eurobond activity reaching new annual records. Eurobond volume was up 77% year over year, with more than 400 firms active on the trading system. Emerging market volume was up 54% from 2015, with approximately 800 client firms trading.

We believe our growing global client footprint and the breadth of our trading capabilities create a strong foundation for future growth. Our history of cross-selling success also gives us confidence in our ability to develop new marketplaces, such as municipal bonds and leveraged loans. For the full year 2016, we had 727 client firms trading three or more products on MarketAxess, up from 429 in 2012.

Slide 6 provides an update on Open Trading. Open Trading experienced another record year, with average daily volumes up 86% from the fourth quarter of last year. Approximately 125,000 Open Trading transactions were completed during the quarter, compared to 58,000 in Q4 2015.

We continue to be encouraged by the increasing number of unique liquidity providers or price makers on the platform. The fourth quarter saw 660 firms providing liquidity, up from 469 in Q4 of last year. This expanding pool of participants helped drive a 223% year-over-year increase in Open Trading price responses. Clients taking liquidity on the system saved an estimated $29 million in the fourth quarter, due to the expansion of the liquidity pool.

The profile of Open Trading liquidity providers continues to be fairly evenly split between dealers, investors, and alternative market makers. The ETF community is increasingly active and we're investing in additional trading functionality and ETF analytics for this growing client segment.

Over 18% of combined US high-grade and US high-yield volume on MarketAxess now takes place through Open Trading, up from approximately 13% a year ago. Participants benefit from average cost savings of approximately 3 basis points in yield when they complete a US high-grade transaction using Open Trading protocols. Open Trading technology enhancements will remain a key focus area for investment in 2017.

Slide 7 provides an update on the global regulatory landscape. Regulatory change continues to have a meaningful impact on our clients and on our business. In the US, we are monitoring the regulatory landscape as it unfolds under the new administration. Our current understanding is that it is unlikely that we will see any proposals to reduce bank capital requirements. Higher bank capital requirements have led to balance-sheet constraints for market making.

However, it is widely expected that we could see changes in the implementation or delays in more controversial aspects of financial regulation, like the Volcker Rule. There is also much discussion on potential corporate tax reform. MarketAxess would benefit from lower overall US tax rates. However, some proposals on lower taxes for the repatriation of foreign earnings or a reduction in the tax deductibility of corporate interest payments could have a negative impact on the pace of growth of new debt issuance. It is far too early to speculate on the outcome of potential tax changes.

In Europe, we are focused on the opportunities presented by MiFID II in relation to clients' increased preference to trade on regulated venues that can help them fulfill their new obligations under MiFID II. We expect that the new regulatory focus on demonstrating best execution will lead to increased demand for electronic trading, as well as data products that allow market participants to compare transaction prices, such as Axess All.

In sum, we currently believe that the likely regulatory and tax changes will be net positives for the Company, but it is too early to predict the outcome within any degree of certainty.

Now let me turn the call over to Tony for a more detailed look at our financial results.

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

Thank you, Rick. Please turn to slide 8 for a summary of our trading volume across product categories.

US high-grade volumes were $185 billion for the quarter, up 29% year over year. The increase in volume was evenly split between an improvement in market share, from 15.1% in 2015 to 17.2% in 2016, and an estimated 14% increase in TRACE volumes.

Volumes in the other credit category were up 49% year over year. Emerging market bond volumes increased 59%, due to growth in estimated market share and an increase in estimated market volumes. Gains in our Eurobond and high-yield trading volume were almost entirely due to a pickup in estimated market share.

In January, we are seeing year-over-year market volumes across our core four products up an estimated 10%. We expect that our overall average daily trading volume in January will be above the fourth-quarter level. With five trading days remaining in January, estimated US high-grade market share is demonstrating a decline from the December and fourth-quarter levels beyond the typical seasonal movement and reflects the impact of the record pace of new issuance early in the year.

On slide 9, we provide a summary of our quarterly earnings performance. The 23% year-over-year increase in revenue was primarily due to the uplift in trading volumes and resulting 27% improvement in quarterly commission revenue. If the dollar versus sterling exchange rate held constant year over year, overall revenue would have increased by an additional $2.7 million. On a constant exchange-rate basis, information and post-trade services revenue increased by 14% on stronger data sales.

Total expenses in the fourth quarter were $44 million, up 11% year over year and up 15% on a full-year basis. We continue to invest in our business and at the same time deliver improved operating margins. For both the fourth quarter and full year, pretax income increased by 30% or more and the operating margin percentage for full-year 2016 reached 52%.

The effective tax rate was 34.1% for both the fourth quarter and full-year 2016. Compared to 2015, the 100 basis-point reduction in the full-year effective tax rate reflects a higher percentage of income attributable to lower tax rate jurisdictions and a reduction in certain statutory foreign and state tax rates.

Our diluted EPS was $0.88 on a diluted share count of 37.7 million shares.

On slide 10, we have laid out our commission revenue, trading volume, and fees per million. The 36% increase in total variable transaction fees was entirely due to the increase in trading volume. US high-grade fee capture declined by $4 per $1 million on a sequential basis. There was no appreciable change in the average years to maturity or trade size bucketing between the third and fourth quarters. We expect that first-quarter 2017 US high-grade distribution fees will be similar to the fourth quarter of 2016.

Our other credit category fee capture increased by $12 per $1 million on a sequential basis, primarily due to a fee plan change for European bonds. Dealers were given the choice of adopting one of several standard plans, consisting of varying minimum monthly commitments. Under the new plans, distribution fees are eliminated and fees per $1 million traded differs based on maturity. The overall Eurobond fee capture now looks similar to our US high-grade figure.

For the fourth quarter of 2016, Open Trading revenue was $11 million, more than double the fourth quarter of last year, and open trading protocols were responsible for 15% of overall trading volume.

Slide 11 provides you with the expense detail. On a sequential basis, expenses were slightly above the third-quarter level. Higher Open Trading related advertising costs were offset by lower variable bonus accrual and employer taxes.

On a year-over-year basis, higher compensation and benefits cost accounted for the largest variance, reflecting a rise in headcount and greater variable bonus accruals. We closed out 2016 with headcount of 383, compared to 342 at year-end 2015. The year-over-year growth in professional and consulting fees was driven by implementation efforts surrounding several important infrastructure projects, and higher Open Trading related advertising costs accounted for the bulk of the marketing and advertising expense increase.

On slide 12, we provide balance sheet and capital management information. Cash and investments as of December 31 were $363 million, and in 2016 free cash flow reached a record $136 million. Dividends and share repurchases aggregated $63 million or approximately 46% of free cash flow in 2016.

Our current quarterly dividend is an important element of our capital management strategy. The 27% increase in the quarterly dividend followed a 30% increase in 2016 and 25% increase in 2015. We have now increased the dividend in seven consecutive quarters -- seven consecutive years.

During the fourth quarter, we repurchased 63,000 shares at a cost of $10 million under our share buyback program. As of December 31, approximately $51 million was available for future repurchases under the program.

We are increasing the investment in our trading platform, new protocols, and infrastructure and view this continuing investment spend as a competitive advantage. Through our existing cash position and strong cash flow generation, we have the flexibility to fund our investment priorities and return capital to shareholders.

On slide 13, we have our 2017 expense, capital expenditure, and income tax rate guidance. We expect that total 2017 expenses will be in the range of $192 million to $208 million. The midpoint in that range suggests an approximate 12% year-over-year increase in expenses, which will be slightly above our five-year compound annual growth rate, adjusted for the Trax acquisition in 2013. For purposes of generating the expense guidance, we have assumed that the sterling to dollar exchange rate holds at 1.25 to 1.

We expect that 2017 capital expenditures will range from $25 million to $30 million. The midpoint in that range reflects an increase of approximately $9 million over the 2016 level. The majority of this increase relates to a new data center buildout and upgrades to existing data centers.

We expect that the effective tax rate for full-year 2017 will range from 32% to 34%. The mix of US and foreign source income and the impact of a new standard governing stock-based compensation accounting could cause variations in the effective tax rate.

Beginning in 2017, there is a mandated change in stock-based compensation accounting, which impacts, among other items, the accounting for windfall tax benefits, statement of cash flow classification of such tax benefits, and the computation of diluted share count. Our tax rate guidance incorporates an estimate for the windfall tax benefit related to restricted stock schedules invested in 2017, but does not include any windfall tax benefit on the potential stock option exercises since we can't predict when such exercises will occur. This standard will create volatility in our quarterly effective tax rate.

Also, while we don't provide specific guidance on our diluted share count, we estimate that the new standard will increase our diluted share count by approximately 400,000 shares beginning in the first quarter of 2017.

Rick had some earlier comments on the potential changes in US corporate tax policy. Based on the information available, we estimate that every 1 percentage-point reduction in the US federal corporate income tax rate would have increased 2016 EPS by approximately $0.04 per share.

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

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

Thank you, Tony.

We are pleased with the full-year results we were able to achieve in 2016. It is clear that the adoption rates for electronic trading in global credit markets are accelerating. Our success in Open Trading is adding valuable new liquidity solutions to our dealer and investor clients. Our global client footprint continues to grow, supporting both geographic and product expansion. Regulatory changes are likely to continue to support growth in open electronic markets.

And let me close with a word of thanks to all of our employees. Your innovative spirit and dedication delivered outstanding results again in 2016.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Patrick O'Shaughnessy, Raymond James.

Patrick O'Shaughnessy - *Raymond James & Associates, Inc. - Analyst*

I was curious if you have any preliminary thoughts on what sort of impact any relaxation of the Volcker Rule might have. Obviously, it's very early and we don't know if it is even going to happen, but curious if you have any expectations of what it might mean in terms of market share or liquidity or anything else.

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

Our belief is that it would be a net positive for market liquidity if there was some relaxation in the implementation of the Volcker Rule.

Where it really has an impact in credit currently is in less liquid bonds, where, if it is difficult to prove the ability to turn those bonds back over in an expeditious manner, it is difficult to comply with the current Volcker Rule. So we think it would open up more market making in less liquid areas of credit and it would allow bank-owned dealers, if they choose, to use their capital more for proprietary trading. The net result of that, we believe, would be a positive for market liquidity.

Patrick O'Shaughnessy - *Raymond James & Associates, Inc. - Analyst*

Thanks. And then maybe one for you, Tony. With your expense guidance for 2017, it is a pretty wide range from the low end to the high end. Can you talk about what sort of drivers might cause it to come in at the high or the low end and, I guess, what are some of the key areas that you are planning on investing in in 2017?

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

Sure, Patrick. I would say one thing on the range, or the absolute range, arguably in the past we have probably provided too tight of a guidance range, but when you think about it top to bottom, if you take the midpoint we're talking about a 4% swing from top to bottom.

And those big swing factors or those big variables there, it is typical of what you have seen in the past. We have headcount, which there is an expectation that we will grow headcount in 2017 at a similar pace to what you have seen the past two years. The timing of when that headcount additions come in and attrition is a little uncertain, so that could be a swing factor.

You know we have the variable bonus accrual that is tied to operating performance. We generally build that accrual over the course of the year as a percentage of pretax, pre-bonus income. That could swing from top to bottom.

And, honestly, foreign exchange, which you did see that in 2016, that foreign-exchange movement could impact the expense results. And we have something like GBP40 million to GBP45 million of expenses, so if you have a change in the sterling to dollar exchange rate of any amount, it could swing from top to bottom.

Patrick O'Shaughnessy - *Raymond James & Associates, Inc. - Analyst*

Thanks, and then one last one for me and then I will jump back in the queue. So as we look at your Open Trading statistics, obviously you are having a fair amount of success with it. But it looks like you're having particular success with high-yield, and I think by our math maybe one-third or so of your high-yield trades are now being done through Open Trading. Why do you think it's been particularly successful with high-yield?

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

What we see so far is the percentage of Open Trading is highest in the least liquid product areas, and I think it is -- where the expansion of the liquidity pool and utilizing the network more broadly has the biggest impact for clients. So it is quite possible that it is connected as well to the constraints that dealers have, not just on their balance sheet, but also because of Volcker.

So we do see that the Open Trading match rates are greater in high-yield. It is also where we see the most significant activity from the ETF community, which is a growing base of capital that is coming to work in market making and the credit markets.

Patrick O'Shaughnessy - *Raymond James & Associates, Inc. - Analyst*

Great, thank you.

Operator

Kyle Voigt, KBW.

Kyle Voigt - *Keefe, Bruyette & Woods, Inc. - Analyst*

Thanks for taking my question. Just given the recent change in pricing on eurobond trading, I guess I have a separate question relating to the current dealer pay model pricing in high-yield and emerging market products. I know in the past you have stated the desire to eventually migrate this to a client pay model. Can you just give us updated thoughts here and if there is anything in the works over the next 12 to 18 months? Thanks.

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

We're always working on any enhancements or changes in the fee model that would provide the proper incentives for dealers and investors to use the platform more.

And the reality is that we think we have been in a pretty reasonable spot across most products. Eurobond volume growth has been greater than what we have observed in other product areas over the last 18 months or so. So the short answer is we don't have any changes in mind to share with you this quarter, but we have seen great results with the scalability of models that have the concept where a liquidity taker pays and that is what we have embedded into Open Trading. And we believe that, longer term, that will be the model of choice around fixed income electronic trading.

Kyle Voigt - *Keefe, Bruyette & Woods, Inc. - Analyst*

Okay, thank you. And then, you mentioned on the slides Brexit potentially impacting your passport to the EU and that you are evaluating strategic alternatives there. Could you just give us some more color around what options you are considering and if these options would be material with respect to incremental ongoing expenses?

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

Sure, yes, I don't think our current approach is any different than what you would see from other financial institutions that are primarily located in London today.

We are working both with our internal team, as well as our external advisors, to consider a variety of different factors around locations that will continue to be within the EU post-Brexit to look at the regulatory environment across the labor laws, et cetera, to make a determination of where we think we might be best suited, assuming that we need to establish a separate regulatory entity outside of the UK. So, that work is now relatively advanced.

On a relative basis, I don't -- the incremental cost is not that high for us. We would envision that the majority of our employees would remain in the UK, so it's likely that an office within the EU would be smaller and we would seek registration within that regulated entity. But the relatively cost -- the incremental cost would be relatively low.

Kyle Voigt - *Keefe, Bruyette & Woods, Inc. - Analyst*

Okay, thanks. And then last for me is just another follow-up question on the potential rolling back or easing of the Volcker Rule. Just wondering if you view this as a risk at all to the growth rates that you've been posting in Open Trading and some of these other liquidity solutions that you have developed for the market, which are specifically gaining a lot of traction in less liquid products, such as high-yield trading?

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

I really don't. I think that more freedom for dealers to make markets where they choose, subject to their capital constraints, is a good thing, and more market liquidities that improves credit market turnover would be a net positive for us and others in the business. So, we don't see that as an impediment to the growth rates that we have been seeing overall or through Open Trading.

I do think that one of the offsets to this is that there is clearly more regulatory focus on best execution and that is explicit in the MiFID II rule set. And so, investors are very quickly moving to embrace transaction cost analysis for fixed income as part of that new regulatory environment. It is most pronounced in Europe, but we are seeing that trend accelerate in the US as well, with a significant amount of demand for both transaction data, as well as TCA.

So that is one of the factors that I think is continuing to accelerate the adoption rates for investors into electronic trading venues.

Kyle Voigt - *Keefe, Bruyette & Woods, Inc. - Analyst*

Okay, thank you.

Operator

Conor Fitzgerald, Goldman Sachs.

Conor Fitzgerald - *Goldman Sachs - Analyst*

Good morning and thanks for taking my questions. First, just on corporate tax reform and how it could impact MarketAxess, I think there has been a pretty healthy debate this earnings season from CEOs about how much of lower corporate tax rates would fall to the bottom line versus be shared either with employees or competed away. It looks like you are assuming the vast majority of the benefit accrues to shareholders, but wanted to get your thoughts on how lower corporate tax rates could affect that interplay.

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

On the corporate tax rate side, there is obviously still a lot of uncertainty around there because even President Trump's proposals and the House Republican blueprint are not completely aligned, even though over the course of the campaign President Trump's proposals did more closely align with the House Republican side.

Even when I try to model out the impact on 2016, we have to make some assumptions around what happens to research-related deductions and research credits. There is uncertainty around what happens -- on the repatriation side, the two plans are different. They are different on not only how they treat accumulated earnings, but then how they treat earnings on a prospective basis. So, there is still a little bit of uncertainty there.

I would tell you, looking at some of the pieces that some of the sell-side analysts put out, I think we are generally in line with the impact on MarketAxess. For us, 2016, roughly 85% of our earnings were domestic, 15% were foreign. We do expect some shift in that mix going forward favoring the foreign side. And rates today are obviously much lower outside of the US, so like many companies we would benefit from that rate reduction.

Conor Fitzgerald - *Goldman Sachs - Analyst*

Got it. That's helpful. And then just following up your comments around the outlook for new debt issuance, I know your share of trading from new debt issuance is considerably lower than other bonds, but is there a way for you to get a little more specific on your market share for new debt issuance and how we could think about declining DCM activity potentially impacting your volumes?

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

Sure. January is a classic example where we are in a very heavy period of new issuance and, in fact, a reasonable chance that it could end up being the best month for high-grade new issuance ever, and we are in a risk on environment. So, in that kind of combination, investor focus does shift to the new issue calendar, and there are plenty of swaps and trades being done to make room for the new issues.

And the typical pattern that we see is short-term weakness in share around those heavy periods of new issuance, but it typically responds fairly quickly, and our view is that a larger corporate bond market is a very good thing for our future growth. So we have clearly benefited over the last five years as the corporate debt markets have gotten to be about 80% larger over that time period.

So, long term we think that more debt issuance is a positive for the size of the opportunity.

This is one of many factors that we think will be debated extensively throughout this year, and what we are hearing from our advisors is that their expectation is it is more likely that corporate tax changes are going to hit in 2018 versus 2017. So, we really don't know where it comes out, but the deductibility of the corporate interest payment is one of five or six factors that would impact issuance, and you see other important factors like the level of M&A, economic growth, the opportunities for CapEx, and increased investments all having an impact on what we will see from corporate debt issuance.

When you put that altogether, when we look at the Street research currently, the expectation is that 2017 issuance will remain at levels that are close to or around 2016, and certainly January is even faster than what we saw a year ago. So, not a big impact, we think, this year, and so we will learn more about it as the proposals become more clear throughout 2017.

Conor Fitzgerald - *Goldman Sachs - Analyst*

That's helpful. Thanks. And then one more, if I could. On Open Trading, I just wanted to make sure I was interpreting the stats correctly. But it looks like the depth of the order book is improving a lot, if I just look at volume up 86%. The trade response is up plus 200%. But I wonder if you could just confirm that and talk about how the depth on that platform has changed over the last year.

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

Yes, I think that's fair to say that the depth of that market is growing in every client segment. Investor adoption for Open Trading is growing each quarter. We enhanced our technology solutions to make it easier for both dealers and investors to identify potential trade matches through Open Trading. We are seeing new capital come into the market with additional dealers that are focused on electronic markets, market making.

I mentioned earlier that the ETF community continues to grow, and this is a highly valuable tool for the create redeem process and the relative value trading that goes on between ETF shares and bonds. And then, one other efficiency gain from Open Trading is we are clearly making cross-regional business more efficient than it has been in the past. So, each quarter we see greater participation in all of those areas, and we're also seeing dealers using the system increasingly not just as liquidity providers, but as liquidity takers. So it is actually an asset in balance-sheet velocity for dealers. It's another tool and another distribution channel for them to move bonds along more quickly.

Conor Fitzgerald - *Goldman Sachs - Analyst*

Thanks for taking my questions.

Operator

Chris Shutler, William Blair.

Chris Shutler - *William Blair & Company - Analyst*

So, first, I guess just an industry question. So as you think about industrywide volume growth in high-grade, I think you have talked historically about expecting maybe low single-digit type of growth over the long term. Given the 5% growth in TRACE volume in 2015 and then I think 17% in 2016, has your perspective there changed for the next three to five years, I guess, excluding any future regulatory changes? I guess ultimately I am just trying to figure out if industry volume growth could be -- if this is sustainable.

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

There are so many different factors and variables that impact credit secondary volumes it is hard to be overly scientific about predicting where they might go.

What we have said in the past about the long-term outlook is that turnover of credit has been steadily declining over the last five years, and we think that the combination of the new bank capital requirements and the low volatility environment we have been in have contributed to a decline in overall turnover rates. So, the optimistic view would be, look, we may be entering a different period for the interest-rate environment, which could positively impact volatility. There are expectations that economic growth could improve relative to where we have been over the last three or four years.

Volatility would be a positive for market turnover, and if some of the bank regulations are relaxed where it is easier for them to go back to work on what they do well in market making, I think that would be a net positive as well. What we have heard from investors is that their active portfolios have not been turning over at normal long-term averages, and it is directly related to low volatility.

So, we are carefully watching because we think volatility would be good and a relaxation of bank regulations around market making would be a positive. And then, clearly what we and others are doing to really promote all-to-all trading and create a more open market historically has been very good for turnover. So we are contacting market participants that were not able to trade directly with each other in the old model and we are reducing transaction costs, and those two things have historically improved market turnover.

So we are not expecting a wildly different environment for TRACE volumes this year, but longer term we are more optimistic that the growth rates could be higher than what we have seen over the last three or four years.

Chris Shutler - *William Blair & Company - Analyst*

Okay, great. That helps. And then, maybe, could you just give us an update on your progress with loss rates? And I don't know if there any kind of market-share stats you could share there where you stand in the fourth quarter versus maybe a year or two ago. That would be helpful.

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

So, Chris, on block trading, I would tell you on market share, generally speaking, in the fourth quarter we had gains year over year across all size buckets. There were gains in the block trading size bucket as well.

When we measure it -- when we look at the TRACE information, we measure our market share, it comes out to right around 8% of volume.

And it is up year over year, but, again, we're reporting gains across all size buckets. It is probably more evident -- the gains are more evident in our sweet spot right now, but we are picking up share in the block trades as well. And, honestly, when you listen to what Rick is talking about in terms of protocols in Open Trading, a lot of the effort here is around evolving protocols to address larger trade sizes to get more involved in the -- in trading -- in block trade. So we do spend a lot of effort and time with thinking about protocols, focused on the block trade area.

Chris Shutler - *William Blair & Company - Analyst*

Okay, thanks, Tony. And then, just one last real quick one, the fee rate in other credit, which ticked up quite a bit. I know you called out the fee plan change, but when did that fee plan change go into effect? Was it in effect for the full quarter?

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

Yes, for Eurobonds, it was in effect for the full quarter. And at this time, virtually all of the 40-plus dealers have transitioned onto a new fee plan. I did mention in the prepared remarks that that fee capture, the fee capture now, we are four months into it, the fee capture now looks closer to high-grade.

Honestly, it is a little difficult to predict because it is a maturity based -- there are some maturity-based features in there. It does vary by the type of European bonds, so there is some variability in there. But right now, it is looking like -- the fee capture is looking like what you see from the high-grade standpoint.

Chris Shutler - *William Blair & Company - Analyst*

Okay, thanks a lot.

Operator

Rich Repetto, Sandler O'Neill.

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

I guess I am just -- I've been hearing a lot of the questions on the high-yield and the Open Trading, and I can see the dramatic improvements you are making in Open Trading. But I guess I'm trying to see whether I understand the pie charts and stuff correctly. But it looks like the mix moved away from high-yield into the other category, and it actually looks like on high-yield that, at least quarter to quarter, that there was less volume done in high-yield on Open Trading. Am I reading that properly?

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

Rich, I don't know if the pie charts are -- tell the whole story. I'm looking at something, which you don't have in front of you, but from a percentage standpoint, the high-yield percentage of volume represented by Open Trading did increase quarter to quarter.

And I will give you rough numbers. It went from 31% in the third quarter to 34% in the fourth quarter. So it did tick up. I would have to look at, to be honest, look at market volumes in high-yield may have been down third to fourth quarter. I don't have that in front of me right now. But that could be causing some of the variation.

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

Okay, I was just looking at the pie graphs, I guess. And then (multiple speakers)

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

I think it is true within other categories, Rich, that the growth rates in euros and EM in Q4 were higher overall than they were for high-yield, and I think it was just a lower volatility environment through much of the quarter in Q4 that negatively impacted the high-yield volume growth rate. So I think that's what you are seeing in the shift.

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

Okay, but I am. If you just take the 24% of your $831 million in ADV, that would get the high-yield Open Trading volume, correct? From the pie -- the pie says 24% on page six.

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

That is what it should be telling you, yes.

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

Okay, okay. And then, I guess the next question is on the comp and headcount. I guess the question is the quarter was up in revenue nicely quarter over quarter; I'm just trying to see how you accrued for bonuses, the bonus accrual, because it looked like seasonality. There was no seasonality in 4Q as you had a strong revenue quarter.

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

So, Rich, on the variable bonus, we're pretty transparent on how that accrual builds up and how the formula works. If you read our proxy statement, you will see that in all of its glorious details. The formula is spelled out.

In this case, and this typically happens, we will accrue throughout the year based on the formula, and then year-end rolls around and we do lots of other things at year-end. We are looking at peer benchmarking. We are looking at the mix of compensation between variable bonus and equity, and we make that refinement or adjustments at year-end. Albeit this year-end, it is a little more noticeable, and so there was an adjustment pushed through in the fourth quarter. We think it's the right mix from a compensation standpoint, but there was an adjustment pushed through in the fourth quarter, a little more into equity, a little less into the cash bonus accrual.

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

Got it, got it. And Rick and Tony, you have been growing fastest -- at a rapid pace and investing, and when I look at incremental margins, you still got a strong 65%, well above the regular -- your standard operating margin. I guess the question is, I know this was asked, is that -- do you look at the incremental margin in managing that investment spending, the amount of investment spending, as well or is that not -- again, because you are dropping more to the bottom line, well more than what you are investing?

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

Rick, I can honestly tell you that we are not managing to the margin number or really that incremental margin in terms of the investments that we are making.

We arguably -- look over the past three years. We have probably been in the most significant investment period in our corporate life, maybe outside of starting up the Firm. So we have been investing to expand the geographic reach and launching new products and increasing the addressable market and investing in Open Trading, and we have still increased the margin. You look over the past three years, they have gone from 45% to 52%.

So, we're not managing to that margin outcome, but you can see when we have invested heavily it has influenced the topline outcome. You look at the guidance we've provided and we have got another -- planned another year of investment in 2017 and we think for all the right reasons, and you can see that impact coming through in the topline and also in the margin expansion.

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

No question. You got no debate here. You have the topline results with it. Congrats. That's all I had. Thanks.

Operator

(Operator Instructions). Hugh Miller, Macquarie.

Hugh Miller - *Macquarie Research - Analyst*

Thanks for taking my questions. So, just one housekeeping to follow up on the discussion. I definitely appreciate the insight on Eurobonds and the variable fee capture that should be somewhere in the ballpark of high-grade. On the fixed-rate fees, just want to clarify that all the dealers are now in the new plan. Did the fixed-rate fees stay on the fourth-quarter track at roughly about $350,000 or does that fall to zero in the first quarter?

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

Hugh, it probably will not fall to zero in the first quarter, but it may go down slightly, because we are talking about $300,000. There was still one or two dealers transitioning.

And part of these plans, and not to complicate it, but part of these plans, there are monthly minimum commitments built into all the plans. And you'll recall even for US high-grade, where we have a similar concept, if a dealer doesn't meet their monthly minimum commitment, we take that unused monthly minimum and we put it into distribution fee line.

So you are probably still going to see some residuals coming out of Europe on the distribution fee line, to the extent we may have some dealers that aren't meeting their monthly minimum commitments.

Hugh Miller - *Macquarie Research - Analyst*

Got it. Very helpful there. Okay. And then just a question or two on Eurobond, last year we did see that shift in European investor appetite for high-grade -- for US high-grade from Eurobond post the ECB bond buying program. How do you see things in 2017 playing out in terms of mix of interest from European investors between those asset classes?

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

I am sorry, between which asset classes?

Hugh Miller - *Macquarie Research - Analyst*

Between the US high-grade and Eurobond among European investors. We saw a search for yield and some increased adoption of trading in US high-grade from those investors last year. And was just wondering whether or not you would anticipate maybe more of a migration back to Eurobonds trading. We have read a little bit about the ECB potentially being less active in corporate bond buying this year. Just was wondering if you anticipate that there might be any changes in terms of that mix.

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

I would expect more of the same. You have got stronger economic growth and lower unemployment in the US, which is causing the Fed to begin increasing rates here, which is likely to increase the yield differential between the EU and the US, and you have a very strong dollar. So, my expectation would be that we will continue to see healthy inflows from Europe and Asia into US credit products.

Hugh Miller - *Macquarie Research - Analyst*

Very helpful.

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

I would just add that on the -- from a market volume standpoint, even with the ECB actions in the corporate bond space that started up back in the May/June time frame, we haven't seen any appreciable impact on overall market volumes for Eurobonds. We will have to see what happens with this continued ECB program. At least the more recent information is they're going to continue with the buying and ratchet down a little bit in April, but they are going to continue throughout the year.

Hugh Miller - *Macquarie Research - Analyst*

Okay, helpful, helpful, thank you. And another one there, obviously you guys have indicated that you are having tremendous success in terms of taking share of electronic trading in Eurobonds. But as we think about just the overall level of electronic trading in Eurobonds, is there an expectation that we should see a greater percentage of bonds being traded electronically over the near and medium term or would you anticipate that level of electronic trading should be fairly steady?

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

What we are hearing from both dealer and investor clients is that the MiFID II obligations around trade reporting are so comprehensive that there will be growing appetite to conduct those trades electronically.

And I think we will run into the same differentiation between block trades and flow trades, where you have fewer block trades and clients will have different views about the best way to execute them. But for any flow trade or low-impact trade, our understanding in talking with many investors and dealers is that it is going to be far easier and more cost effective in Europe to conduct those trade electronically and comply with all the new trade reporting rules that they both have. So, we would expect -- and we have already seen that to an extent that the electronic share of the Eurobond market has been increasing. We would expect that to continue into the implementation of MiFID II next January.

Hugh Miller - *Macquarie Research - Analyst*

Got it. Appreciate that insight, and then last for me, just as we think about the investment last year you made in munis and levered loans, are you guys comfortable just giving us a sense of how you guys are thinking about the impact of that in 2017? Is there either a revenue or a market share target or range that you guys are thinking about and striving for for this year?

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

Yes, both higher. (laughter)

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

I will second that one.

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

Listen, where we are today in our core markets is very different than where we were five or 10 years ago. What we have learned is that any new market takes time, and while we're working with many of the same clients and dealers, we are working with a different set of traders. I will tell you that the numbers in munis in particular month in, month out, quarter in, quarter out are getting better and we continue to invest very heavily in enhancements for the municipal bond market. The same can be said of leveraged loans.

And we had approximately 160 investors active on our muni platform in Q4 and about 50 dealers, so in that market we've moved from onboarding to trading and we're starting to see each week the activity levels grow. And we continue to believe that our technology solutions are a very good fit for the municipal bond market. So we remain optimistic and we will continue to invest throughout 2017 and beyond.

Leveraged loans is in an earlier stage. We are onboarding more clients and dealers. It is earlier stages. We are doing trades and we're optimistic there. It is really hard to predict exactly what the growth rates will be, but, as I mentioned in my prepared remarks, we are confident that we have the right solutions for both of those markets.

Hugh Miller - *Macquarie Research - Analyst*

Great, great, I appreciate the update there. Thanks so much for taking my questions.

Operator

I'm not showing any further questions at this time, so I will now turn the call back over to Rick McVey for closing remarks.

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

Thank you for joining us this morning. All the best for 2017, and we look forward to talking to you next quarter.

Operator

Ladies and gentlemen, this does conclude the program and you may now disconnect. Everyone, have a great day.
