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MKTX - Q1 2012 MarketAxess Holdings Inc. Earnings Conference Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. At this time, all participants are in a listen-only mode. Later, we will conduct a question and answer session.

(Operator Instructions)

As a reminder, this conference is being recorded on Wednesday, April 25, 2012. I would now like to turn the call over to Mr. 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 first quarter 2012 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 beliefs regarding future events that, by their nature, are uncertain. 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, 2011. 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.

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

Good morning, and thank you for joining us to discuss our first quarter 2012 results.

We are pleased to report another set of strong quarterly results, with record revenues of $50.7 million, up 16% from a year ago, driven by strong credit market trading conditions and increases in market share from the prior year period. Pre-tax income was a record $22.7 million, 29% above the first quarter of 2011. Diluted EPS improved to $0.35 compared to $0.27 one year ago. On the heels of significant growth in client inquiry flow, across all trading categories, total trading volume was a record $158 billion, up 17% from a year ago. Emerging market and high yield volumes were both up over 30% from the first quarter of 2011, leading to a 9% improvement in overall fee capture per million traded.

Slide 4 displays some details on our quarterly results and financial strength. Strong revenue growth in the quarter was the principal driver behind the record pretax income of $22.7 million. EBITDA was up 28% to a record $24.6 million in the first quarter of 2012. Operating and EBITDA margins improved to 45% and 49%, respectively. Incremental margin for the quarter was 71%. Our cash and securities available for sale balance at March month end was $180 million, or $4.65 per diluted share.

We continue to return money to shareholders through share repurchases and dividends. During the first quarter, we repurchased 2.4 million shares, including 1.8 million shares from J. P. Morgan as part of their sale of shares acquired as a founding dealer of MarketAxess in 2000. We expect the share repurchases to be accretive to earnings, and secondary trading liquidity has improved in our shares since the offering. The Board approved a regular quarterly dividend of $0.11 per share.

Slide 5 provides an update on market conditions. The first quarter of 2012 saw significant improvement in the credit trading environment in both the US and Europe, compared to the fourth quarter of 2011, following the introduction of the ECB long-term refinancing operation in early 2012. Credit spreads and credit-spread volatility declined during the quarter as investor sentiment improved and risk appetite increased. The improved market conditions led to record quarterly US high-grade trace volumes of $864 billion, and healthy new issuance volumes of $254 billion for the first quarter of 2012.

Sovereign debt issues have reemerged in Europe in April, and market trends across products in the very early part of the second quarter are softer than the first quarter averages. April volume trends in both high-grade and high-yield are about 15% below the first quarter of 2012. Inflows into bond funds remains strong, in spite of the flattening of the yield curve over the last year. The block trading percentage of trades represented 42% of total trace volume, down from 46% in the first quarter of 2011. And primary dealer balance sheets are down approximately 52% over the same period.

Slide 6 highlights our improved client and dealer participation. US high-grade investor order count reached a new record during the quarter, and was up 21% from the prior year period. The number of active US high-grade trading clients also hit a record during the quarter. Dealer hit rates have been hovering in the 70% range for the past three quarters, down from approximately 78% in the first quarter of 2011. The level of dealer balance sheets committed to market making provides an ongoing challenge in meeting investor needs to source liquidity, especially during times of order imbalance.

We believe the increase in capital requirements for bank-affiliated dealers represents a permanent change in dealer balance sheets for market making. We believe we are ideally positioned to provide credit market solutions due to our e-trading technology capabilities and our vast trading network. We are launching new functionality this quarter to enhance market lifts, our electronic open-order book. We have also introduced improvements to our dealer-to-dealer offering to respond to dealer interest in using MarketAxess to increase inventory turnover. While still a small part of our overall results, D-to-D trades and volume were up over 300% from the first quarter of '11, and up over 25% sequentially from the fourth quarter. Estimated high-grade market share was 11.4% for the first quarter, up 150 basis points from the prior year, but down from 12.2% in the fourth quarter of 2011. With four important trading days still remaining in April, we currently expect April high-grade market share to be around the first quarter level.

Slide 7 summarizes the trading volume across our product categories. Overall global volume in the first quarter was up 17% year-over-year to $158 billion. Trace volumes set a new quarterly record, but were just slightly above the first quarter of 2011. The 15% increase in our US high-grade volume to $98 billion was due solely to market share gains. Eurobond volumes were $12.7 billion, the highest in two years, and up 13% from the first quarter of last year. The increase reflects improvement in the region's market conditions, and early signs of support for the fee plan changes we implemented in the first quarter.

Total trading volume from European clients in the first quarter was approximately $23 billion. Emerging market and US high-grade trading volume from European clients was up 65% from year-ago levels. Our Other product category volume increased to a record $47 billion in Q1, up 21% from a year ago, driven principally by high yield and emerging markets volume gains. As previously referenced in our monthly volume statistics reporting, we are no longer reporting CDS volumes in the Other category. However, the first quarter marked our best period ever for CDS trading. We continue to make enhancements to the CDS platform, and onboard dealers and clients.

The regulatory timing continues to shift, and we now expect the CFTC SEF Rules to be finalized in the second half of 2012. The final Volcker Rules have also been delayed, and bank-affiliated dealers will have two years to comply with the final rules. As a result, we do not expect any further changes to dealer market making in the near term, due to the Volcker Rules.

Now let me turn the call over to Tony for more detail regarding our financial results.

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

Thank you, Rick.

Slide 8 displays our quarterly earnings performance. Revenues of $50.7 million were up 16% from a year ago, driven principally by growth in variable transaction fee commissions. The year-over-year and sequential declines in technology products and services revenues were due to lower professional services fees and the impact of a design shift to a rental model for software sales. Total expenses were $28 million, up 8% from the first quarter of 2011, and 7% sequentially from the fourth quarter. First-quarter expenses reflect some seasonal and one-time items, which I will cover momentarily.

Pre-tax income was a record $22.7 million in the first quarter, up 29% from last year. Our effective tax rate for the first quarter was 40.7%, up from 39% in the first quarter of 2011. We are trending toward the higher end of our 2012 tax guidance range, due principally to a decline in foreign-sourced income. Our diluted earnings-per-share was $0.35 on 38.7 million diluted shares.

On slide 9, we have laid out our commission revenue trading volumes and fees-per-million. Distribution fees were $16.1 million during the first quarter of 2012, up 6% from the first quarter of 2011, but down 4% sequentially from the fourth quarter. On our fourth quarter call, we flagged the distribution fee reduction on our major Eurobond fee plan, as well as several dealers, including MF Global, that were coming off of the major US high-grade fee plan.

In addition to these changes, one more US dealer has migrated to the all-variable plan at the beginning of the second quarter. Absent any other changes, compared to the first quarter 2012 level, distribution fees are projected to decline by approximately $1.8 million in the second quarter of 2012. We expect some offsetting benefit in variable transaction fees relating to this most recent dealer migration. US high-grade fees-per-million were $188 in the first quarter, which was consistent with the fourth quarter of 2011, but up from $172 in the first quarter of 2011. The year-over-year change was primarily due to an increase in the duration of bonds traded and an increase in volume derived from broker-dealer clients on the all-variable plan.

There is some noise in the Eurobond fee capture in the first quarter as we were transitioning dealers to the new fee plan. Given the current mix of corporate and government bond trading on our platform and fee plans in place, we expect that our Eurobond fee capture will continue to average around $65 per million. The Other product category fees-per-million were $202 in the first quarter of 2012, up from $166 in the fourth quarter of 2011, and $176 in the first quarter of 2011. The sequential and year-over-year increases in fees-per-million was due to product mix shift in this category, resulting principally from significant growth in emerging markets and high yield volumes.

Slide 10 provides you with the expense detail. Total expenses for the first quarter were $28 million, up 8% from a year ago. Excluding a sales tax reimbursement claim of $700,000 recorded in the first quarter of 2011, expenses were up 5% year-over-year. The first quarter 2012 expenses include approximately $200,000 of costs associated with the J. P. Morgan secondary offering and seasonally higher payroll taxes and advertising spend. We continue to expect that our full-year 2012 expenses will be within our original guidance range of $107 million to $112 million.

On slide 11, we provide balance sheet information. Cash, cash equivalents, and securities available for sale as of March 31, were $180 million compared to $248 million at year-end 2011. In addition to paying out our annual incentive bonuses during the first quarter, we also returned $75 million to shareholders through share repurchases and our quarterly dividend. The trailing 12 months free cash flow for the period ended March 31 was $70 million. Our capital structure now consists of a single class of voting stock, and we continue to have no bank debt.

Slide 12 gives an update on share repurchases and changes in our shareholder base. Since mid-December 2011, we have repurchased a total of 2.6 million shares of common stock. We expect that our second-quarter diluted share count will reflect the full impact of these recent share repurchases and, at current share price levels, would expect it to be approximately 37.8 million shares. There is 10 million in authorized repurchases remaining under our $35-million program, which at this point, we would expect to use opportunistically. The J. P. Morgan secondary offering marked another step in increasing the public float and diversity of our shareholders. In the past three years, the average daily trading volume in MarketAxess shares is up more than five times, and the average daily dollar value of MarketAxess shares traded is up 15 times.

Now let me turn the call back over to Rick.

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

Thank you, Tony.

We are pleased with the record results from the first quarter. Trading volume and revenue momentum is evident in many of our product areas, and we continue to demonstrate operating leverage. The changes taking place in fixed income will require new solutions and will ultimately increase the addressable market for electronic trading.

In closing today, I would like to extend a very personal thank you to Nick Rohatyn, our Lead Independent Director. After playing an instrumental role in the founding of our business, and 12 years of service on the MarketAxess Board, Nick has decided to step down following the end of the current term in June. It has been a privilege to work with Nick through our formative years, and all shareholders have benefited from his vision, advice, and support. We will continue to call on Nick as a friend and fellow shareholder for years to come, even though his official responsibilities as a Director will soon come to an end.

Our nominating and governance committee has successfully recruited two new outstanding Directors to our Board. Jim Sullivan is the head of Fixed Income at Prudential Investment Management, and an industry leader in credit markets. Steve Begleiter is a Senior Principal at Flexpoint Ford, a private equity group. Steve has extensive investment banking and business-building experience. We welcome both Jim and Steve to our Board, and we look forward to working with them.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question will be coming from the line of Howard Chen, from Credit Suisse. Please proceed.

Howard Chen - *Credit Suisse - Analyst*

Good morning, everyone. Just a couple fee quick questions. First, Rick, you spoke to the really high growth in inquiry count during the quarter, and we can see that on slide 6. Could you elaborate a bit more exactly where that's coming from and what your expectations are going forward in terms of growth in inquiry count?

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

Yes. I think it's a couple things. I think it reflects that in our normal sweet spot for trading activity, we're seeing an increase in inquiries coming in from existing clients. We continue to work on clients that we think are under-utilizing the platform, and we have made progress with many of them with respect to the increase in activity. And as we also mentioned in the prepared remarks, we've seen very good growth in inquiry count from cross-regional clients, most notably out of Europe. So I think it's really been across the board, and it has been the primary driver of the increases in market share.

Howard Chen - *Credit Suisse - Analyst*

Great, thanks. And then shifting over to Europe, just wanted to dig into some of that outlook and commentary on the variable pricing. I guess I don't quite understand what exactly is going on that's driving that reduced outlook to the 65 level. So if you could please elaborate on that, that would be great.

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

Sure, Howard, it's Tony. There's a couple things in there, probably the first thing to note is that when we look at our Eurobond volume, it really is a combination of corporate bonds and government bonds. And the way our fee plan works right now, corporate bonds generally are at 100 per million, and government bonds are at 10 per million, so that mix definitely influences the fee capture. The second one, which is a little bit of a nuance, we did have a number of dealers who were on a hybrid plan, sort of similar to our US high-grade all-variable plan, we had several dealers who were on a hybrid plan paying a reduced fixed monthly distribution fee, a variable fee, and then an execution fee. We've now centered really around one fee plan that now eliminates that execution fee that some of these hybrid plan dealers were paying, so that hybrid execution fee was influencing fee capture prior to the fee plan change.

And that's why, looking at it going forward, it's really just the mix of corporate at 100 and government bonds at 10, depending on that mix, that $65 guidance could swing higher or lower. And I will tell you, we are also very active in onboarding new dealers. These would, in all likelihood, be sort of more regional dealers out of Europe. They would likely be on an all-variable plan, so that also could influence the fee capture going forward. But at least right now, in terms of near-term guidance, think about it more around that $65 or $70 range.

Howard Chen - *Credit Suisse - Analyst*

Perfect, thanks. And that's very helpful, Tony. Finally, Rick, thanks for that update on the CDS and timing as you think about it. Just wanted a little bit more of an update. Are you charging today? And if not, how do you think about adjusting that fee schedule over time as you gain traction and share within that market? Thanks.

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

Sure. No, we do not have any fee schedule in place today for CDS. And, quite honestly, there are enough uncertainties in the final SEP Rules and the timing of implementation that we do not expect to change that policy in the near term. We're doing the best we can with uncertain information about the rules to prepare the trading system in every respect to be ready to register as a SEF. And, Howard, I would expect that the fee model and fee capture will probably become more clear around the time that the SEF Rules go fully into place.

Howard Chen - *Credit Suisse - Analyst*

Perfect, thanks. Congrats on the strong results and for taking the questions.

Operator

Your next question will be coming from the line of Patrick O'Shaughnessy, from Raymond James. Please proceed.

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

Good morning, guys. First thing I wanted to ask is, Rick, if I heard you correctly you said that April to-date, your US high-grade market share is running around 11.4%, basically what you did in the first quarter?

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

That's correct. We said it's around the first-quarter levels.

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

Okay. So if that's the case, it seems like over the last few months, your market share has stalled out a little bit and certainly the long-term trend has been positive, but are you seeing some near-term headwinds that are kind of preventing you from seeing that next uptick?

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

No. You're correct, Patrick, we've been a little bit flat here over the next last couple of periods after a pretty steep increase. And as you know from history here, as well as all of the other companies that you covered, nothing ever moves completely in a straight line. But we're pretty excited about the future. We do think that the long-term trend in block trading is reflecting a decline. We expect that to continue given the capital requirements and the dealer balance sheet constraints.

We continue to promote the price improvement that investors are achieving on the MarketAxess system due to the level of competition on the platform. We are really excited about the early signs of take up in D-to-D trading and the enthusiasm that the dealer community has for the enhancements that we're putting into place this quarter. And as you know, D-to-D trading typically represents somewhere around 25% to 28% of trace. So when we put all those things together, along with some of the enhancements that we're making, the market lists and the regulatory trends, we feel pretty optimistic that the electronic share is going to continue to grow over the next two or three years. It's difficult to predict quarter in quarter out what that path will look like, but we like the outlook.

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

Okay, that's fair. Thank you. Next question, as far as the other category, fee capture, sounds like you just had a really favorable mix shift. Is that a mix shift that you think is sustainable going forward?

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

Patrick, you're right, it was a pretty marked mix shift. And just to put it in perspective, we have the three main products in that category, which are emerging markets, high yield, and agencies; and just looking at 2011, look at emerging markets and high-yield, higher-margin or higher-fee-capture products, they represented something like 46% or 47% of the volume in that category. We fast-forward to the first quarter, and emerging markets and high yield were more like 55%. So, that's what really drove the significant outperformance in fee capture. It is sustainable at least -- you heard some comments from Rick around where volumes are trending for April, again, very early in the month. High yield, trace volumes are down around 15%; hard to gauge where emerging market volumes are.

We've seen the same thing in agency volumes where again they're trending down from the first-quarter levels. But we're most excited really are -- it is around emerging markets and high yield. We think that we can continue to grow market share there. So, having said all three products are growing, so we're going to have to suffer a bit through the products mix shift as we go forward. But at least where we are today, and what we're seeing in terms of increased client participation, cross products, it's again hard to say whether we can sustain this volume mix. But at least in the near term, it looks pretty favorable.

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

Okay, thank you for that. And then, Tony, follow-up on the distribution fees. So, I think you said all told it's going to drop by about $1.5 million in the second quarter? I think I have that roughly right. And then, most of that's going to be in the Eurobond distribution fees, but some of it's also going to be in the US high-grade? Does that sound right?

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

Patrick, what I said is we think it will drop, based on what we know today, we think it will drop by about $1.8 million, versus the first-quarter level. And, think of it as sort of a two-thirds/one-third split between the US and Europe. US being two-thirds of that number, around $1.2 million, and Europe being one-third or around $600,000. And, what we have here in the US, there's two dealers that, at the very end of the first quarter, very beginning of the second quarter, migrated off of the fixed plan into the variable plan. Both were paying $200,000 per month. You look at the second-quarter impact, it's around $1.2 million.

And on the European side, we do have the carryover impact from the March 1 fee plan change. And the impact there, quite frankly, is a little bit less than what we had anticipated. There are several dealers who have yet to migrate from paying 50,000 euros per month to 25,000 euros per month. So, the impact in Europe is a little bit lower than what we had originally anticipated, but $1.8 million in total. And, Patrick, I'd say again, that's based on what we know today. I mentioned before that we're hoping to onboard some European dealers, albeit most of those we think will be all-variable plan dealers

We have the same thing in the US where we're in the middle of onboarding a number of new dealers. There's also several dealers who are on the variable plan right now that may or may not upgrade to the fixed plan, yet to be seen. So there is some movement here in between plans and in the distribution fees, but at least, based on what we know today, that's the best guidance we can give for Q2.

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

All right, got you. And then one last modeling question if I could, on the technology products and services revenue line item, sounds like you changed your business model a little bit there, in terms of how you charge, so is the $2.9 million that you put up, in terms of revenue in the first quarter, kind of the new run rate going forward?

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

It's a good question, Patrick. And it really is really the new data point or baseline that we would suggest modeling off of. And there's two things there; it's not only the shift in the revenue models. So previously, software sales were a one-time revenue event; so one-time license event in the month that you booked the license and deliver the software, you recorded the revenue.

Beginning in the fourth quarter, we began the shift to a revenue model, which we believe is beneficial long term, increases recurring revenues; we think it's the right thing for the business, definitely some short-term pain when you do that. So that is one item driving it. And really the second item, I mentioned in the prepared remarks that the professional services fees were down versus the fourth-quarter level. We are making some adjustments in our professional services focus areas, some geographic adjustments, and that's why, when you look at Q1, we'd really think that would be the new data point or the jumping off point for tech services going forward.

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

All right, very helpful. Thank you.

Operator

Your next question will be coming from the line of Hugh Miller, from Sidoti & Co. Please proceed.

Hugh Miller - *Sidoti & Company - Analyst*

Good morning. I guess I need to log-in quicker, almost all my questions were asked. I guess I had one housekeeping about the tax rate. Seemed to come in a touch higher than what we've seen in the past, and just your expectation going forward for that?

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

Sure. The tax rate -- there's lots of estimates that go into a tax rate, and the single biggest one is projecting out for the full year, income by taxing jurisdiction. So you have to make some estimates going forward. You're also estimating out levels of permanent differences like meals and entertainment, which are nondeductible, and tax-free interest. You could also have discrete items that impact the tax rate, like a tax rate change or an audit conclusion, but when you look at where we are in the first quarter, 40.7%, and, even if you compare it to the full year 2011, which was around 39.5%, it's definitely up.

And two things, two items in particular, the biggest one is the reduction in foreign-source income. So for us, foreign-source income is predominantly coming out of the UK within our provision. It's taxed at 35%. You compare that to US-source income, which is taxed at something above 40%. So when you take federal plus the state impact, something above 40%, that mix of US- and foreign-source income is a big factor, and the biggest factor in why our tax rate is up.

The second thing is, at least right now, Congress has not extended or acted to extend the research credit. We have some pretty substantial expenses around our capitalized software, and improvements that we're making to the trading platform around CDS and D-to-D and open trading and all the other initiatives we have on. But right now, since Congress hasn't acted, we can't build that into the effective tax rate. So, right now, it is trending at the higher end of the range. But, Hugh, there's things that could happen if Congress acted on the research credit. There's other favorable permanent differences around option exercises that could influence the rate. But, again, based on the projections right now, it looks like we're trending at that higher end.

Hugh Miller - *Sidoti & Company - Analyst*

Okay, great color there. And I know you guys reiterated your expense guidance for the year. Was just wondering if you could give us a little bit of color on some of the geographic expansion efforts that you are taking upon you now, and then how that might influence costs, if there is much in the way of costs associated with that?

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

Sure, Hugh. And why don't I -- I'll tackle the first part on the expense guidance. Let me give you a little more color on that. And within the expense guidance, it does include some of this geographic expansion that we have going on, predominantly in Brazil and in Southeast Asia. But when you look at -- we reiterated our guidance, $107 million to $112 million for the full year. If you take that Q1 expenses, there's definitely a couple of one-time items and some seasonal items in there that wouldn't make Q1 really be a normal run rate.

We did have the J. P. Morgan offering costs in there for $200,000. There's definitely some seasonal payroll taxes that do run through the first quarter. Order of magnitude on that one for 2011, payroll taxes in the first quarter were $700,000 higher than Q2 through Q4, and that's because we have the way FICA works, and we have restricted stock vesting in the first quarter that generates employer taxes, so it's definitely a big seasonal item there. And even to a lesser extent on our advertising spend in the first quarter, particularly around CDS, was higher than what we would expect going forward. We also had a bad debt charge at our Technology Services Group, which we hope to reverse in future periods, but we have a very formula-driven bad debt reserve policy right now, so when something ages out not so gracefully, we end up reserving for it. When you tally up these items, it comes out to somewhere around $1 million that, if you take that $1 million off of the first quarter expenses, that would get you a jumping off rate of something like $27 million for the quarter.

So, just in terms of overall guidance, if we make some adjustments to the first quarter, again, it gets you to somewhere around $27 million. Baked into our forward-looking estimates, it does include some of the geographic expansion. Some of those expenses, they're already built in, even in the first quarter. So, we did open the office in Brazil, we have staffed up that office. We do have several people already on the ground in Singapore and Hong Kong. There's a couple of hires that will come onboard as we go throughout the year; so again, baked into the guidance, does include some of the geographic expansion as well.

Hugh Miller - *Sidoti & Company - Analyst*

Great color. And I guess moving into the color and detail you gave us with regards to the shift in the two dealers on the US high-grade platform, going to variable from kind of the all-you-can-trade option, was wondering if you're getting a sense as to what's causing them to make that change? And I realize that the next question will be dependent on volumes from them, but do you anticipate that shift is going to be somewhat revenue-neutral in the second quarter? Or not?

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

And, Hugh, let me clear up on the two dealers, because, in one case -- and this was one that we had previously flagged -- it's a dealer that had ramped up in response to the credit crisis several years ago, ramped up a debt. They have closed down the debt, so in that one particular case, we don't think that there's going to be a variable-revenue offset. So that's one of them.

And the second one that just migrated off the beginning of the second quarter, yes, we do think that there will be a variable-revenue offset. They have a -- the way many of the dealers work on the variable plan, there is a minimum commitment. It's not quite what they were paying in terms of their distribution fee. But we do think there will be a revenue offset. It might not be exactly one-to-one, but there should be a revenue offset for that one.

Hugh Miller - *Sidoti & Company - Analyst*

Okay, great. And then the last question I had was just with regards to, we've had a little bit of time since some of the news that hit the papers again about BlackRock's offering for client-to-client trading platform. Was just wondering if you could give us your sense on any potential competition that you could foresee from that over time and your thoughts there?

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

Yes. Happy to take that one, Hugh. I do think the discussions around the crossing network are reflective of growth in interest among all investors in promoting and establishing alternative sources of liquidity and moving toward a more open and electronic model for fixed income. And, quite honestly, what BlackRock has said publicly about their intentions doesn't overlap significantly with what we do.

And our own view is that any increase in electronic connectivity in credit markets will ultimately be a good thing for both MarketAxess and the overall market. So, we have seen broad-based support in the new initiatives that we have around market lists and some of our initiatives to complement dealer liquidity with open-order books. We think we are on the right track there, and we are seeing very good early signs of support around those initiatives and some others that have come up along the way.

Hugh Miller - *Sidoti & Company - Analyst*

Okay. Appreciate your insight there, thank you so much for answering my questions.

Operator

(Operator Instructions)

Your next question is coming from the line of Matthew Heinz, Stifel Nicolaus.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Good morning, guys. Wonder if I could get an update on some of the new initiatives you highlighted at the investor day, primarily revolving around the retail initiative and the client-to-client open trading?

Tony DeLise - *MarketAxess Holdings Inc. - CFO*

Yes, happy to comment on those. The D-to-D initiative, as we've said in the past, is mostly focused on helping dealers clean up smaller balance sheet items. And this is directly related to the new regulatory capital requirements. In the old model, dealers were perfectly happy to sit on thousands of line items, many of which might have been $3 million and under, and wait until they found a client order on the other side. That has changed entirely, and there's more interest now in using any possible channel to move those inventory items along more quickly.

So, mostly what we're seeing is an interest in using MarketAxess and, specifically, our list functionality to move smaller line items, typically $3 million and $4 million and under out through the system. It serves as a product pipeline for lots of regional dealers that may have an end-investor order that the large dealers are not seeing. And I think it's a very positive development for us, and it's a way that we can add value back to the dealers in light of the capital requirement changes that they are facing.

On the market list side, there was a lot of interest in opening up orders on the MarketAxess system throughout 2008. Market liquidity improved in '09 and 2010. And the vast majority of business went back to the traditional channel between investors and dealers. There's more interest again in complementing dealer liquidity with the open-order book. We've made some enhancements to our market list functionality, so that it's streamlined, and we believe will be more efficient for all market participants to use. And many of those enhancements and changes are going out this quarter.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Okay. And then one follow-up on the BlackRock network. Just wanted to get your incremental thoughts on how that could impact you, not so much from a competition standpoint, but more on how it could impact the volume that BlackRock currently does on your platform?

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

What they said again, Matt, is that they're focused on crossing block trades within their own portfolios. What you and others saw last week was clarification that they have pretty modest expectations in terms of the amount of business that can ultimately be crossed, because of the level of fragmentation and illiquidity in most corporate bonds. So, I think at the margin that they expect to get some benefit to this -- from this, they've been clear that they don't have any interest in disintermediating the street. They don't expect to become a broker-dealer, so we view what they're doing as complementary to what we do on the MarketAxess system. And, as I mentioned, we think there are ways that we can increase electronic connectivity with all major clients in the years ahead.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Thanks. And one quick follow-up to that, have you seen any more major institutional clients that are implementing similar minimum-size requirements like BlackRock has that require certain smaller trade sizes to go through MarketAxess?

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

We aren't privy to the internal policies of any of our clients. I think it's pretty clear by the growth in our market share that more and more investors are embracing the notion that a greater percentage of their trading should be done electronically. And we think that if we continue to deliver efficient functionality that allows them to access broader sources of liquidity through these changing times, that we will be successful in continuing to grow our share. So we really don't have anything that we know specifically about internal policies, but we can see very clearly, not just in high-grade, but across almost all of our major product categories that there is a trend toward greater electronic trading in credit.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Okay. Thanks a lot.

Operator

Your next question is coming from the line of Niamh Alexander, from Keefe, Bruyette & Woods.

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

Hello, good morning; thanks for taking my questions. If I could just -- on this potential for other venues and to be out there; it's taken you a long time and a lot of client relationships to get to where you are, but didn't MarketAxess also at one point set up the functionality for buy side to match buy side? And it's just very challenging. Is that fair? People have to show their liquidity and, I'm just trying to get a sense of how difficult it really could be for somebody like BlackRock or even competitors to come out and do something.

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

Yes. That's right, Niamh. When we do the deep dive on Trace, even if you had access to 100% of the client orders during the day, you wouldn't see a huge percentage of matching opportunities. And it is reflective of the nature of the securities in credit that they trade infrequently.

In fact, the vast majority of corporate bonds that are reported to Trace only trade one time per day. So there's a limited universe of more liquid bonds that could create some matching opportunities. We think the market list functionality and a few other things that we can do to complement what we do with multi-dealer liquidity today are very positive steps in that direction. But you're right, the total matching opportunity because of the illiquidity in the market is relatively small.

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

Okay. Fair enough. Thanks for clarifying, Rick. And then, if I could go to Europe, because you saw -- I guess we have another step down in price, but for a very short time, it was very good over there. You're starting to see corporate issuance and finally disintermediation of bank lending. The stocks you showed us at the analyst day for the quarter were looking really good in terms of volume. Is that fair?

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When things normalized, you did see -- there is potential for a significant lift to the revenue base there, just from the activity. Is it more kind of the industry activity? Or is it still more your market position right now and it is kind of limiting the growth there?

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

Well, two things on that. We do think we have a much larger opportunity in Europe. We've said in the past that we need to do a better job delivering unique liquidity and technology solutions. We've been fast at work on that every quarter. We did see a significant turnaround during the first quarter. But the market over there continues to be very volatile and very sensitive to sentiment shifts around sovereign debt concerns.

And you would know more about that than we would, Niamh, but our guess is that, that's here to stay, that this is not going to be solved in a quarter or two, and that, over the next two or three years, we're going to be faced with these swings in investor sentiment that radically change the risk appetite and the liquidity in the market. And we'll see positive periods as we did during the first quarter. We are optimistic that all of the initiatives to provide backstop funding for European sovereigns will ultimately pay off along with the fiscal responses that are working their way through the European region. But it's not going to happen overnight, and I think we will see ebbs and flows in sentiment and market activity over the next few years.

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

Okay. Fair enough, Rick, and lastly on the revenue side again, you're seeing phenomenal growth in the revenue line helped by the emerging markets and the high-yield and that seems to be where a lot of the flows are going this year as well. You've had to pick up in the rate capture. Do you think that it's within your sights that maybe that product category could, at some point, exceed the core high-grade category in the next two, three years?

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

Well, we're pleased with the growth. If you're looking for a forecast of where that's going, I think the best we can do is to be transparent with you on the trends in the fee models. The other category has consistently been outstripping the growth percentage in volume in the high-grade category. And we do like the fact that we're seeing the market share trends coming through across more products, more clearly now than we may have two years ago. And as we've said many times, with EM and high-yield, the market's at an earlier stage in embracing electronic trading. So we do think there is a significant growth opportunity there and we think we're on the right track.

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

Okay. Fair enough. Thanks.

Operator

(Operator Instructions)

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

It sounds like there are no further questions, so thanks very much for joining us this morning and we look forward to talking to you next quarter.

Operator

Ladies and gentlemen, that concludes today's conference. We thank you for your participation. You may now disconnect. Have a great day.