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CORPORATE PARTICIPANTS

Dave Cresci *MarketAxess - IR*

Rick McVey *MarketAxess - Chairman, CEO*

Tony DeLise *MarketAxess - CFO*

CONFERENCE CALL PARTICIPANTS

Patrick O'Shaughnessy *Raymond James - Analyst*

Michael Adams *Sandler O'Neill - Analyst*

Niamh Alexander *KBW - Analyst*

Hugh Miller *Sidoti - Analyst*

Howard Chen *Credit Suisse - Analyst*

Michael Wong *Morningstar - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by. At this time , all participants are in a listen-only mode. Later we will conduct a question-and-answer session. (Operator Instructions). As a reminder this conference is being recorded July 24, 2013. I would now like to turn the call over to Dave Cresci, Investor Relations Manager at MarketAxess. Please go ahead, sir.

Dave Cresci - *MarketAxess - IR*

Good morning. Welcome to the MarketAxess second quarter 2013 conference call. In the call, Rick McVey, Chairman and Chief Executive Officer, will review the highlights for the quarter and will provide an update on trends in our businesses and then Tony DeLise, Chief Financial Officer, will review the financial results.

Before I turn the call over to Rick, let me remind you that today's call may include forward-looking statements. These statements represent the Company's belief regarding future events that, by their nature, are uncertain. The Company's actual results and financial condition may differ materially from what is indicated in those forward-looking statements. For a discussion of some of the risks and factors that could affect the Company's future results, please see the description of risk factors in our annual report on Form 10-K for the year ended December 31, 2012. I would also direct you to read the forward-looking disclaimers in our quarterly earnings released issued earlier this morning and is available on our website.

Now let me turn the call over to Rick.

Rick McVey - *MarketAxess - Chairman, CEO*

Good morning. Thank you for joining us to discuss our second quarter 2013 results. This morning we reported our second quarter financial results with record revenues and pretax income. Revenues were $65.6 million this quarter, an increase of 34% from the previous year, with pretax income up 49% to $31.5 million. Expenses were $34 million, including a one-time favorable adjustment relating to certain out-of-period employee costs which Tony will cover in more detail. Earnings per share for the quarter were $0.51 up from $0.34.

Our growth this quarter was driven by record market share and volumes across our three core products, high-grade, high-yield, and emerging markets. We were especially gratified to achieve this pace of growth in a period of rapidly rising interest rates and shifting fixed-income investor sentiment. Our board has approved a $0.13 regular quarterly dividend.

We completed the first phase of our integration with BlackRock Aladdin during the quarter, and we continue to see promising momentum in our open trading initiatives. In May, the CFTC finalized its rules governing the trading of derivatives on swap execution facilities, and we recently submitted our application to the CFTC for registration as a SEF. Adoption of our CDS products continues, and our CDS volumes were up 21% in Q2 from Q1 reaching a new monthly record in June.

Slide four provides an update on market conditions. In the last quarter, we saw a rapid increase in interest rates with 10-year Treasury yields reaching 2.5% at the end of the second quarter, compared to 1.9% at the end of Q1. In addition, we witnessed a directional shift for taxable bond fund flows, especially in the latter part of the quarter, resulting in net outflows for the quarter. Credit spreads widened and volatility increased.

The shift in market sentiment and increase in volatility led to a 15% increase in high-grade TRACE volumes year-over-year. Second quarter TRACE volumes were higher than Q1 contrary to normal seasonal patterns. Primary dealer holdings of corporate bonds picked up modestly, but remain at historically low levels. The proposed increase in capital requirements and restrictions on bank leverage ratios are likely to continue to constrain primary dealer balance sheets from market making.

We believe that electronic trading will continue to play an important role in connecting a broad network of market participants to create new sources of liquidity in credit markets. We are encouraged to see the increase in TRACE volume and market share during the second quarter as credit market conditions became more difficult.

Slide five highlights our continued strong growth rates and diversification. Growth rates in the first half of the year are consistent with our attractive long-term averages. The primary drivers of our revenue and earnings growth, our market share gains and our core products, high-grade, high-yield and emerging market bonds. The number of investor clients trading all three products has increased by 60% since 2010. Our average daily variable transaction revenue increased 36% year-over-year, with the strongest growth coming from other credit products. Variable transaction fees from European clients were also up over 30% year-over-year demonstrating continued engagement from European investors.

The acquisition of Xtrakter has further diversified our revenue stream. This quarter we began delivering end of day trade data from Xtrakter through the MarketAxess bond ticker data service and we remain optimistic about the opportunity to increase our value proposition in Europe through a combination of unique trading and data products.

Slide six provides information on market share trends in our core products. This quarter we saw an acceleration in our market share growth despite the increase in interest rates. The primary contributor to market share gains this quarter was an increase in investor order flow. High-grade investor inquiry count was up 29% year-over-year and overall inquiry count was up 39%. Our continued investment in open trading protocols is increasing the appeal of the platform to investors as they search for new sources of liquidity. 65% of US high-grade orders were submitted to market lists in the second quarter, and we saw a 79% sequential increase in completed open trading transactions compared to Q1.

We completed the first phase of BlackRock Aladdin integration during the quarter, which creates seamless work flow from a Aladdin client order blotters into the MarketAxess open trading functionality.

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

Tony DeLise - *MarketAxess - CFO*

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

Our overall global trading volumes were up 30% year-over-year to a record $188 billion. US high-grade volumes were also up 30% to a record $118 billion on a combination of market share gain and a 15% increase in TRACE volumes. Volumes in the other credit category were up 47% compared to the second quarter of 2012. We posted record volumes in both high-yield and emerging markets during the quarter.

Consistent with the driver behind high-grade market share growth, the improvement in high-yield and emerging markets trading volume was a result of an increase in investor order flow. With six important trading dates remaining in July, month to date US high-grade traits average daily volume is running approximately 15% below the second quarter level, but around 10% above July 2012. Investor sentiment has improved dramatically in July causing our month to date order balance to shift to the offer wanted side. Our estimated high-grade market share is currently running slightly below the second quarter level.

Slide eight displays our quarterly earnings performance. Revenues of $65.6 million were up 34% from a year ago, driven principally by a 27% increase in trading commissions and the inclusion of a full quarter of Xtrakter results. Total expenses were $34 million, up 23% from the second quarter of 2012. Expenses reflect a favorable out of period adjustment of $1.6 million. This item increased second quarter net income by $1 million and diluted EPS by $0.02.

Our effective tax rate for the quarter was 38.6% and within the full year guidance range of 38% to 40%. Our diluted EPS was $0.51 on 37.8 million diluted shares.

On slide nine, we have laid out our commission revenue, trading volumes, and fees per million. The 39% improvement in variable transaction fees was due to the 30% increase in overall trading volume, a positive product mix, and relatively stable fee capture across high-grade, high-yield and emerging markets products. US high-grade fees per million were $195 in the second quarter, up slightly from the first quarter. Among other items are US high-grade fee capture is sensitive to yields and years to maturity of bonds traded. During the second quarter, the impact of higher yields was more than offset by a slight extension in maturity and higher execution fees.

Fees per million in the other credit category were $309 in the second quarter of 2013, up from $271 a year ago and from $296 in the first quarter. Higher fee capture emerging market and high-yield volume accounted for the increase and represented 87% of the other credit category volume in the second quarter compared to 80% one year ago.

Distribution fees were $14.8 million in the second quarter of 2013. We currently expect that third quarter 2013 distribution fees will be approximately a $0.5 million above the second quarter level.

Slide ten provides you with the expense detail. Second quarter 2013 expenses as reported were $34 million, and include $5.3 million of Xtrakter operating expenses. During the quarter we recorded a favorable out of period adjustment to include employee incentive compensation in a pool of costs eligible for deferral under our software development capitalization policy. The second quarter as adjusted column excludes the impact of this adjustment which affected the composition and benefits and the depreciation and amortization line items.

Total expenses as adjusted were $35.6 million. Almost half of the year-over-year increase related to higher compensation and benefits largely driven by the Xtrakter acquisition.

Our total head count as of June 30 was 327. We continued to invest in new product areas and expect that head counts could increase by another ten or so personnel by year-end.

The increase in depreciation and amortization year-over-year as adjusted reflects a significant capitalized software development and equipment spending in the past several years, together with the amortization of the Xtrakter tangible assets. The $1.9 million year-over-year increase in professional and consulting costs is largely due to higher recruiting fees and technology consulting costs.

On slide 11, we provide balance sheet information. Cash, cash equivalents, and securities available for sale June 30th were $150 million compared to $180 million at year-end 2012 and $143 million at March 31. During the first half of 2013 we expended approximately $38 million to acquire Xtrakter and paid out our year-end employee cash bonuses of roughly $19 million and paid cash dividends totaling $10 million.

Our return on equity for the first half of 2013 was approximately 27% and has increased from 4% five years ago. The improvement in ROE has resulted from a combination of strong annual earnings performance and return of capital. There was no change in our capital structure during the second quarter. we have no bank debt outstanding and didn't barrow against our revolving credit facility.

On slide 12, we have summarized our 2013 expense, capital expenditure, and income tax rate guidance. There is no change to our 2013 expense and tax rate guidance. We now expect that full year 2013 capital expenditures will be between $21 million and $24 million. The $6 million increase in estimated capital spending primarily relates to the buildout of new office space in London following the Xtrakter acquisition, which we expect to occupy in the fourth quarter of 2013, and higher new product software development costs.

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

Rick McVey - *MarketAxess - Chairman, CEO*

Thanks, Tony. We are very pleased with the strong growth in our business this past quarter, especially given the shift in market trends. Increases in overall market volumes and market share drove our record result record results. We continue to be optimistic about the potential for open trading to help support market liquidity.

In Europe we are building on early integration efforts with Xtrakter and we are excited about the potential to develop unique trading and data products that will help improve liquidity and transparency in the European markets. And the finalization of the CFTC's SEF rules for swap trading is increasing adoption rates for CDS electronic trading and provides more clarity for market participants.

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

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). Your first question comes from the line of Patrick O'Shaughnessy, Raymond James. Please proceed.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Good morning, guys.

Rick McVey - *MarketAxess - Chairman, CEO*

Hello, Patrick.

Tony DeLise - *MarketAxess - CFO*

Hi, Patrick.

Patrick O'Shaughnessy - *Raymond James - Analyst*

So my first question is slide six in the lower left hand corner there you talk about contribution of market share gains in the second quarter, and you pretty much attribute it all to investors having higher inquiries. The first part of my question there is I had always thought that when investors are looking to sell down their portfolios that the hit rates tend to be better in that environment. So I am a little bit surprised why hit rate did not contribute to market share gains. And the second part of the question is for the market share gains, the increased inquiries that you did see, can you talk about are you seeing more people participating on a platform or more people willing to go up larger in trade sizes or what were some of the dynamics you saw during the quarter?

Tony DeLise - *MarketAxess - CFO*

Sure, Patrick. On the first part of the question about bid side versus offer side hit rate, we had some dynamics during the quarter where early in the quarter the investor sentiment was on the offer side. In the June time frame it was on the bid side. When you looked at the second quarter compared to both the first quarter and the second quarter of last year, the bid/offer ratio over the entire quarters were about the same. It was a fairly balanced order flow.

But you're right. Typically we do do better on the bid side than the offer side. But that dynamic over the course of the entire quarter didn't play out that way. That's number one.

In terms of the number of clients, I can't say there is anything appreciable in the overall number of clients participating. We did continue to see that trend where we have more cross-selling going on, more clients trading all three products.

Your other question around trade sides, we look across trade size and whether it was high-grade, emerging markets or high-yield the average trade size was about the same across second quarter 2013, first quarter 2013, second quarter 2012.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Okay. That's helpful, thank you. Second question I have is with interest rates on the way back up, you said that during the second quarter the duration was extended out a little bit which I think is a little surprising. As you guys are looking at June and July trends, are you seeing the duration come back and are you expecting any revenue capture implications from that?

Rick McVey - *MarketAxess - Chairman, CEO*

Why don't I take the first question. And I think as we mentioned in last quarter's call, the increase in rates we saw especially during the second half of the second quarter has offsetting flows with different types of investors. So you did see the mutual fund outflows that lead to some selling, but we also have a group of client market participants that have cash available to invest at higher yields, most notably the insurance portfolios and some of the sovereign wealth funds.

So the action during the quarter continued to be at the longer end of the curve and although the expectation was that the Fed may gradually start reducing the monetary stimulus that they have been providing, there were really very little changes in the short end of the curve. So the trading activity for us continued to be at the longer end of the curve causing a slight extension of average maturities traded on the system.

Tony DeLise - *MarketAxess - CFO*

Patrick, the only thick I add is the yield curve actually steepened over the course of the quarter. So where you saw long-term rates go up and specifically the 10-year Treasury go up, you didn't see any real movement on the short end. So you did see a steeper yield curve.

Patrick O'Shaughnessy - *Raymond James - Analyst*

That's helpful. Last one from me and I will jump back in the queue. Can you talk about high-yield, emerging markets, what sort of market share you were seeing in the products during that quarter?

Rick McVey - *MarketAxess - Chairman, CEO*

Pretty consistent with what you have seen from us over the past several quarters. We typically don't talk very granular around high-yield and emerging markets market share, but when you look back at the first quarter for high-yield, for example, it was almost a doubling year over year in market share. When you look at the second quarter a big sequential increase, you are not quite doubling year-over-year in market share.

I will tell you in terms of high-yield because we can get more granular with the trace information. We were around that 5% level. It is a little less scientific on the emerging markets side because the information that does come out of the trade association is on a delayed basis. I don't have perfect information for the second quarter. You can look at what happened in the other credit category up 47% year-over-year, big sequential increase as well. We think most of that is a result of market share gains.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Very helpful. Thanks, guys.

Operator

Thank you. Your next question comes from the line of Michael Adams, Sandler O'Neill. Please proceed.

Michael Adams - *Sandler O'Neill - Analyst*

Good morning, gentlemen. Congrats on another really strong quarter here.

Rick McVey - *MarketAxess - Chairman, CEO*

Thanks, Michael.

Michael Adams - *Sandler O'Neill - Analyst*

So following up on Patrick's first question around some of the market share drivers, the one thing on that same slide, slide six, is jumping out at me is the 80% sequential increase in open trading trades that were completed in the quarter. I'm just curious, was any of that driven by the completion of the phase one integration with BlackRock or is there a little bit of pent-up order inquiry once that phase two of the integration gets completed.

Rick McVey - *MarketAxess - Chairman, CEO*

Sure, speaking of the -- just as a caveat, we are still in the early days of open trading and we are encouraged by the growth rates in market list orders, prices back in completed trades. With respect to BlackRock specifically the phase one integration was just completed in the last few weeks. It is making it much easier for not only BlackRock, but all of the Aladdin client users to seamlessly operate within the MarketAxess trading functionality, and we are starting to see an increase in activity on the platform from that community. But that is very recent.

Michael Adams - *Sandler O'Neill - Analyst*

Got it. That's helpful. And since we are on BlackRock, has the collaboration to date identified any new areas of focus, new trade protocols, pricing models, et-cetera? Any sort of color on the early discussions you guys have had? I would be curious to hear.

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Rick McVey - *MarketAxess - Chairman, CEO*

Sure and the answer is yes in all of the above. It is not just BlackRock. In our opinion the validation that they have provided for MarketAxess being the best positioned venue for developing these new liquidity solutions is having a much broader impact on the investor community in general.

And specifically during the quarter we hosted an Investor Working Group meeting with 16 of the largest US fixed income money managers, and there was a higher level of engagement than ever before, a deeper dive around the work flow for the existing protocols and lots of great ideas on enhancements and new protocols. So the focus is running very high and obviously the market need for new liquidity solutions is very clear.

So I think we are getting a benefit from our direct involvement from BlackRock. We are getting an involvement from both companies' investment into work flow solutions for the Aladdin client base and even more broadly we think it has increased the level of attention and engagement around the MarketAxess trading solutions with all investors.

Michael Adams - *Sandler O'Neill - Analyst*

And then maybe a question for Tony. You were just talking about some of the share gains you have seen and the high-yield and the EM trading. I'm curious, is the mix pretty constant right now in terms of volume between high-yield and EM? And the reason I ask is I know it has some implications for the capture trends that have been improving nicely the past couple quarters here.

Tony DeLise - *MarketAxess - CFO*

Again, looking at that other credit category, you can see the significant year-over-year and sequential increase. Just getting a little more granular and not to get exact with this granularity, what we have seen more recently is high-yield has been growing a little faster than EM, but both of them are growing 40% plus. So it is not that any one of them is tailing off in anyway, but high-yield has been slightly higher in terms of the more recent growth rates.

Michael Adams - *Sandler O'Neill - Analyst*

That's great, Tony. And one more for you, just a minor clarification here. On the full year guidance, does that include -- I know you didn't change your expense items, but does that include the $1.6 million benefit for the out of period adjustment you realized this quarter?

Tony DeLise - *MarketAxess - CFO*

Yes, it does. Yes. On the guidance side, I mean you saw what we posted for the first half of the year in terms of expenses. Inclusive of that outer period adjustment, there was just a little north of $65 million. We gave you that column which shows you 2Q as adjusted, and that is really the jumping off point for the second half of the year. You look at that $35.6 million which is the second quarter as adjusted. I would use that as a proxy for moving forward.

And then realizing we have had a fair amount of hiring in the second quarter, there is some additional positions we expect to fill in the second half of the year. So once you get the full impact of all of that hiring, what we are telling you is expect the second half expenses to tick up from that as adjusted second quarter level.

Michael Adams - *Sandler O'Neill - Analyst*

Got it. Thanks, Tony and congrats again, guys.

Rick McVey - *MarketAxess - Chairman, CEO*

Thank you.

Operator

Thank you. Your next question comes from the line of Niamh Alexander, KBW. Please proceed.

Niamh Alexander - *KBW - Analyst*

Hi, thanks, and congrats from me too on a very, very strong quarter and nice leverage.

Rick McVey - *MarketAxess - Chairman, CEO*

Thanks.

Niamh Alexander - *KBW - Analyst*

The comment on your market share, thanks for sharing. I guess June was so, so high at 16.6%, but to clarify you satisfied you were tracking below the 14.2% you did for the full quarter, is that correct?

Rick McVey - *MarketAxess - Chairman, CEO*

Yes, Niamh. We are a bit of an unusual month. We are 16 days into the month. There are 22 trading days in the month. If you look at the first week of the month, it was around the Fourth of July and there was some noise and there was some softness in that first week.

We still have six trading days left here. We've gotten into this habit of giving you a prelude of the current month traits and market share numbers. There are still six trading days left. It is an offer wanted trade flow right now coming into the platform, and we are tracking slightly below that second quarter level.

Niamh Alexander - *KBW - Analyst*

That's really helpful. I appreciate you sharing. Thank you.

On the high-grade and emerging markets end, remember last year you talked about putting some boots on the ground and some local people into the local emerging markets. Is that benefiting some of the flow you are seeing there, or is that still US customers predominantly trading those products? If it is not, when do you think you will start getting some of the benefit of the local presence and the local products?

Rick McVey - *MarketAxess - Chairman, CEO*

The progress that we have made in EM over the last four to six quarters is primarily driven by US investors that are active in emerging markets and European investors. The local markets activity is starting to tick up, and actually in Brazil specifically the tax on foreign investment was just removed in June. Following that change we have seen a modest uptick in cross-regional flow into Brazil local markets. But safe to say, Niamh, that is in the early stages and represents a relatively small part of our EM trading activity so far.

Niamh Alexander - *KBW - Analyst*

Fair enough. Thanks. We will watch the space as it were. On Xtrakter, you have been with it -- you have had it now for two quarters. You have mentioned kind of starting to sell the data -- the market data to the bond indicator. How is that going? Help me think of some revenue synergies you were seeing that you had some confidence in initially when you closed the deal.

Rick McVey - *MarketAxess - Chairman, CEO*

From a business perspective I think everything is on track. What we really believed the opportunity was with the combination of Xtrakter/MarketAxess Europe is exactly according to the initial expectations, and we are very encouraged by both the dealer and investor response to some of the ideas we have around the data products. The timing of achieving those synergies is always an open question, but we feel at least as strongly about the opportunity today as we did in the months that we were analyzing the acquisition opportunity.

Niamh Alexander - *KBW - Analyst*

Okay. Fair enough. And then I guess on the capitalization, what was it exactly, sorry if I missed it on the call, but what was it that you capitalized that you were accruing quarterly before?

Tony DeLise - *MarketAxess - CFO*

Sure. There was -- and this will be a little bit of an accounting exercise here, but in accordance with US Generally Accepted Accounting Principles, we capitalized our software development costs associated with internal use software. So I am giving you a technical description here. What that means is once projects -- if we are doing a significant build around our open trading platform, once that project reaches the technological feasibility, we start deferring the costs and then they are amortized over three years once the project goes into service.

It's very typical and every company out there is doing the same thing. What happened in our case in the second quarter , we were doing a review of the pool of cost we were capitalizing, and we determined specifically that we weren't picking up the incentive bonus pool. So we went through an exercise of analyzing what the impact would be historically and what the cumulative impact would be. We pushed through the cumulative impact in the second quarter.

The important piece is going forward we are going to start deferring or as part of our capitalization policy, we will start deferring the employee bonuses for our development and QA team on qualifying projects. But I think the important message is that we don't think that will have a material impact on our results going forward. What you will have is a deferral of bonuses, but then you are also going to have the amortization expense rolling through. Net-net, it may affect the line items, but we don't think it will have a material effect on the given quarter in a given year prospectively.

Niamh Alexander - *KBW - Analyst*

Okay, that makes sense. Thanks for expanding on it. Lastly, if I could -- I saw you registered with the CFTC for SEF, but I guess single name credit derivatives is a product we would associate with your potential revenue opportunity. Maybe we are wrong. Maybe it should be the index. That's something the SEC not defined the rules yet so you can't apply for SEF status. If that is the case, should we think about the ability to capture revenue in 2014, and if we don't get those rules defined, or would it be better to think of it as more of a longer-term opportunity?

Rick McVey - *MarketAxess - Chairman, CEO*

It remains to be seen. We agree, we have seen nothing so far from the SEC that would indicate their timeline for securities-based SEF rules which will govern the single name CDS market.

We will see what happens. Certainly there has been an increase in the number of CDS clients on the MarketAxess system over the last two quarters. Some of those clients are active in both index and single name products. The trading rules for index will be implemented early in the fourth quarter, so we would expect that to drive another uptick in electronic trading in the index product.

One would think that too would cause people to trade more of their single name trades electronically, but we have no way of knowing currently when the rules will be implemented by the SEC for single name swap trading.

Niamh Alexander - *KBW - Analyst*

Now, you are not showing as volume currently, but customers are executing on the platform. Are you charging customers yet, or when can we get some timing on when you can do that?

Rick McVey - *MarketAxess - Chairman, CEO*

We are not charging for CDS transactions yet, and as we have said in the past, we would expect to begin charging for transactions around the implementation of the SEF rules. Just by way of caution, one of the changes in the final rules was the lowering block trading threshold which reduces the percentage of CDS index volumes which is subject to the trading rules in the first year.

So we are guessing now that somewhere around half of CDS index volume will be subject to the new rules and the other half will qualify for block trades which are exempt in the first year from SEF rules. And given that CDS index swaps are the most commoditized and liquid swaps, we expect transaction fees for indices to be relatively low. You should see some revenues emerging by the end of the year, but in our opinion, it is not likely to be material to company results.

Niamh Alexander - *KBW - Analyst*

Okay. Fair enough. Thanks, Rick. I will get back to in line.

Operator

Thank you. Your next calls from Hugh Miller, Sidoti. Please go ahead.

Hugh Miller - *Sidoti - Analyst*

Good morning. Thank you for taking my questions.

Rick McVey - *MarketAxess - Chairman, CEO*

Hello, Hugh.

Tony DeLise - *MarketAxess - CFO*

Good morning, Hugh.

Hugh Miller - *Sidoti - Analyst*

In piggybacking off of the last conversation about CDS, you know, it is a great point you made there about the commoditized nature of index trading. You guys had talked about the rise in volume activity on the platform, but do you think that with index trading relative to single name that is going to be very price sensitive in that there is not much of a value-add from the platform because it is not so thinly traded? What are your views there? And do you think that we could go to an environment where it is just people flocking to whoever is the low-cost provider?

Rick McVey - *MarketAxess - Chairman, CEO*

I think it is a fair comment. What you see in commoditized products, it is more difficult to differentiate your trading solution based on unique liquidity or trading functionality. When you look at where we have differentiated ourselves historically, in the bond areas, we think it is about developing world-class technology solutions for highly fragmented, less-liquid markets where we have been able to demonstrate that we have a liquidity and technology advantage. And when systems lack those advantages, obviously it shows up in pricing. We would expect as we have said in the past that CDS index pricing is going to look a little more like on the run government bond electronic trading pricing than it is corporate bonds.

Hugh Miller - *Sidoti - Analyst*

Right. Okay. Can you just review the figures you guys had put out with the increase in volume activity on CDS, and is there a disparity right now at this point between the growth and index versus single name trading on your platform?

Rick McVey - *MarketAxess - Chairman, CEO*

It is fair to say most of the growth right now is coming from the index products. Having said that, we still believe that we are the only platform that is live in index single name and options on indices, and we have trades going through to the platform consistently in all three.

Hugh Miller - *Sidoti - Analyst*

Okay. Great color there. Another question just about the shift in sentiment and market dynamics with outflows happening toward the latter part of the quarter and then into July. Given that we did kind of see the typical seasonal pattern of slower industry volumes for July relative to June, but the kind of dynamic shift we have been seeing on the flow side, do you anticipate that industry volumes will kind of continue with the seasonal patterns with slower volumes in the second half of the year or does the shift in dynamics probably disrupt that from happening for the industry?

Rick McVey - *MarketAxess - Chairman, CEO*

I think there are two important factors. Obviously the seasonal factors would say all else equal the secondary volumes that tend to be lower than the first half. But all else equal is the $64 million question. What we saw in June is that when the volatility picks up and creates trade opportunities, market volumes go up. We would be optimistic that if volatility does return throughout the second half that you could see some offset to the seasonal factors just like we did in the second quarter.

It is highly unusual and, we think, encouraging to see TRACE volumes overall for Q2 higher than Q1. So I -- in my opinion there have been two factors that have held back secondary trading volume in the last several years . One is the decline in overall market liquidity which has caused an increase in transaction costs. The other is the very low-levels of volatility. What we are working very hard on is providing the new liquidity solutions to reduce transaction costs and improve overall market turnover, and if that is combined with increases in market volatility, we would be optimistic on secondary volumes overall.

Hugh Miller - *Sidoti - Analyst*

Okay. I guess in playing devil's advocate to an extent, at what point would the potential for taxable fund outflows on a consistent basis start to worry you just about overall industry volumes and new issuance?

Rick McVey - *MarketAxess - Chairman, CEO*

Obviously it is a sustained period of out flows and investor selling at some point could exceed the capacity for dealers and others to warehouse that inventory, which is all the more reason why we and the rest of the market are moving quickly to develop alternative solutions.

Hugh Miller - *Sidoti - Analyst*

Okay.

Rick McVey - *MarketAxess - Chairman, CEO*

The market needs to move forward. We have had substantial regulatory change, and it is critical that the market embrace new liquidity solutions and a change in trading behavior so that we can be confident we have a market with more liquidity irrespective of overall investor flows in the direction of interest rates.

Hugh Miller - *Sidoti - Analyst*

Great color there, very helpful. It also seems like in June one of the things that was a benefit on the market share was just the limited new issuance during the month, and I haven't been able to see figures yet on new issuance in July, but is one of the reasons for maybe return to more normalized market share levels reemergence of new issuance, or has that not been the case in July?

Tony DeLise - *MarketAxess - CFO*

Hugh, so far in July what we have seen is new issuance was pretty light. There were a couple of days peppered in there where there was a pretty heavy calendar. So far at least to the first half of the month it looked pretty light.

Hugh Miller - *Sidoti - Analyst*

Okay. And another question I had was with regard to the extension on the years to maturity. It seems like the sentiment I am hearing is that some institutional investors were taking advantage of the steepening of the yield curve. Maybe that's why you were seeing more activity on the longer end for you guys, but do you view a potential risk if the sentiment changes toward rates continuing to rise and the potential for seeing institutions to member go a bit -- to maybe go a bit shorter on the curve?

Rick McVey - *MarketAxess - Chairman, CEO*

I think over time that is certainly a possibility. If shortened yields become more attractive, it is certainly possible some of the flows would move back to the shorter end. As you know, what we have said in the past, that too comes from an offsetting factor. Our market share of shorter maturities tends to be higher than longer maturity. If you get a shift back in that direction, all else equal, we could see a decline in the average fee capture, but we would also expect to come with an increase in the market share.

Hugh Miller - *Sidoti - Analyst*

Great point. That's a very, very good point. And the last question I had was with regards to the commentary of hiring in the second half of the year. I think you guys mentioned about 10 people, and some of the new product development. If you could just give us a bit of a sense of where you are adding to and the opportunities there.

Tony DeLise - *MarketAxess - CFO*

Sure, Hugh. So we have -- just looking at the head count from even the end of the end of the first quarter to the end of the second quarter we ended 21 personnel and I mentioned in the prepared remarks, another ten or so are scheduled for the second half of this year. And in fairness some of those highers up are replacement positions. But in most cases, and this is the vast majority, it is around the new initiatives and particularly Europe. We are doing a fair amount of hiring in Europe, building out not only the infrastructure and adding some capabilities on the data side. It is around open trading.

Even around -- even in our core business, I would say that we continue to build infrastructure to support the growth on the core business. So I could argue every position has been around growth. It has largely been in support of the growth and the newer initiatives, including Europe.

Hugh Miller - *Sidoti - Analyst*

Okay. Thank you very much.

Operator

Thank you. Your next question comes from the line of Howard Chen, Credit Suisse. Please proceed.

Howard Chen - *Credit Suisse - Analyst*

Good morning. Thanks for taking my questions.

Rick McVey - *MarketAxess - Chairman, CEO*

Hi, Howard.

Howard Chen - *Credit Suisse - Analyst*

Rick, you noted a few times the progress in the efforts you are making in open trading. So it certainly feels top of mind. I was hoping you can just refresh us on financial contribution today, any long-term financial goals that you have, and how you hope to see the arc of that growth over time.

Rick McVey - *MarketAxess - Chairman, CEO*

Happy to. As I mentioned it is a small percentage of our completed trades currently, so for the second quarter, open trade transaction revenues are not material to the overall story. But I do think the expansion of trading protocols, and counterparties, and the goal of new sources of liquidity all contribute to the increase in investor order count in volume that we are seeing.

So the response that we are getting from investors is very favorable. I think that it is top of mind for them in terms of developing new solutions. And it is driving more order flow into our system and I think over the next two or three years it is quite possible that open trading could have the same kind of impact on our market share and revenues that the expansion into the regional dealers and alternative dealers did beginning in 2009.

Howard Chen - *Credit Suisse - Analyst*

Thanks. That is really helpful. And then switching gears, even if you exclude the one-time adjustment this quarter your operating margins closer to 46%, they are at a level they haven't been in quite a few years. I know a lot of work goes into achieving that and you and Tony spoke about the traditional second half seasonality and the hiring. But taking a step back, I was just hoping you could comment on your desire to maintain and expand the operating margin in these mid-40s levels if not higher or philosophically investing some of that back into the business.

Tony DeLise - *MarketAxess - CFO*

Sure, Howard. On the operating margins your observation is correct. First half of the year it was around 46%. Even when you take out the out of period adjustment, we did have $1.5 million dollars of extractor transaction costs in the first quarter. So the two counterbalance each other. We are running at about around 46%.

I will tell you that while in the near term, we did provide some guidance on the prior calls around the impact of Xtrakter. We are expecting them in the near term to be earnings-neutral. That does cause some depression in margins or in margin growth. But our expectation going forward, I mean you heard some of the comments from Rick around open trading. If CDS in some way, we get some contribution from CDS, and beyond that, if the data synergies and the trade matching synergies, and if we can drive more flow through to the European platform Xtrakter combination, we do think we can accelerate on the revenue side.

Our expectations going forward are not that we will be stagnant at this mid-40s level. Clearly when we look out in our five-year plans we do have an expansion in the absolute operating margins. We do have -- we do have incremental margins looking more like the historical period. And not that we provide either revenue guidance or margin guidance, but we do expect margins over the longer term to expand from what you are seeing right now, even though we are investing in new initiatives, even though we are continuing to invest in open trading and some international expansion in Europe. Even with those initiatives we do expect margin to expand longer term.

Howard Chen - *Credit Suisse - Analyst*

Thanks, Tony. And then final question from me, I imagine it is not a material driver of this quarter's results, more out of curiosity, if you saw anything unique around the Apple debt offering given the absolute size of that deal?

Rick McVey - *MarketAxess - Chairman, CEO*

I don't think anything earthshattering or out of the ordinary with the Apple deal, but certainly one of the market factors that gives us confidence in the future opportunity is the significant expansion in corporate bond debt in the US market. And since 2008, corporate debt outstanding is up about 50%. So we've got a much larger base of corporate debt, and if we return to more normal levels of liquidity and market turnover, TRACE secondary volume would be closer to $4 trillion per year versus the $3 trillion per year where we have been averaging. So Apple is just one example of opportunistic corporate bond issuers in a low rate environment expanding the base of corporate debt outstanding.

Howard Chen - *Credit Suisse - Analyst*

Great. Thanks for taking the questions.

Operator

Thank you. Your next question comes from the line of Michael Wong, Morningstar. Please proceed.

Michael Wong - *Morningstar - Analyst*

Good morning.

Rick McVey - *MarketAxess - Chairman, CEO*

Good morning, Michael.

Michael Wong - *Morningstar - Analyst*

Are run rate SEF costs already in your results, or will more come in when it is really up and running?

Tony DeLise - *MarketAxess - CFO*

Michael, most of the costs are already built into what you have seen in the first half of the year. There will be a little bit of uptick here with the rule finalization in June around the CFTC SEF rules. There will be some expense expansion in the second half of the year. It is not millions of dollars, but particularly around the compliance and surveillance side, there will be some expansion there. In terms of an annual run rate expansion there is something like $1 million above what you have seen in the first half of the year.

Michael Wong - *Morningstar - Analyst*

Okay. And after the rise in interest rates, have you seen any large differences in behavior between your large and regional broker/dealer clients?

Rick McVey - *MarketAxess - Chairman, CEO*

Not really any shift. The business breakdown between large dealers and regional dealers is relatively stable over the last three or four quarters.

Michael Wong - *Morningstar - Analyst*

And the last one from me, if outflows continue for fixed income funds would you expect a percentage of block trades to increase or decrease?

Rick McVey - *MarketAxess - Chairman, CEO*

The trend in block trades has been down. Anecdotally, what we hear consistently from investors is primary dealers today do not have the capacity to take blocks on to their balance sheet the way they used to, so large dealers are operating on an agency basis increasingly. So our expectation would be given the balance sheet constraints, that the percentage of TRACE volumes and block trades is more likely to continue to decline.

Having said that there hasn't been a significant change over the last six or eight months. We have been fairly stable in terms of block trading volume percentage of trades relative to non-block.

Michael Wong - *Morningstar - Analyst*

Okay. Thank you.

Rick McVey - *MarketAxess - Chairman, CEO*

Thank you.

Operator

Thank you. You have no questions at this time. (Operator Instructions). Your next question comes from the line of Patrick O'Shaughnessy, Raymond James. Please proceed.

Patrick O'Shaughnessy - *Raymond James - Analyst*

A couple quick follow-ups for you, Tony. First, if I heard correctly, you said we should expect distribution fees to be up $0.5 million third quarter versus the second quarter. If I did hear that correctly, can you talk about -- is that US or is it Europe?

Tony DeLise - *MarketAxess - CFO*

So Patrick, it is in the US, and then more specifically we've got one dealer that we are aware of right now that is going to move from the all-variable plan into the plan that has a combination of the fixed-fee and variable elements. So if you remember going back when we had that sort of movement we expect an increase in distribution fees. In this case in the US We would show a corresponding decrease in variable transaction fees. Around net neutral to revenues, but within the components themselves you will see a little bit of a shift.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Thank you. And then my second quick question is if we look at the quarter over quarter increase in your adjusted comp so from $16.4 million in the first quarter to $18.9 million in the second quarter how much of that was due to hiring versus how much was because you had higher variable bonus accrual because it was a strong earnings quarter for you guys?

Tony DeLise - *MarketAxess - CFO*

Patrick, most of that just looking at the absolute numbers most of that comes from the addition of Xtrakter. We had them in for one month in the first quarter and then two months in the second quarter. And then the second biggest item would be around the variable element of our bonus pool which is tied to performance. But the Xtrakter impact is by far and away the bigger of the two.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Thank you very much.

Operator

Thank you. You have no further questions at this time. I would now like to turn the call over to Rick McVey foreclosing remarks.

Rick McVey - *MarketAxess - Chairman, CEO*

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

Operator

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

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