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MKTX - Q2 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 Wednesday, July 25, 2012.

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

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

Good morning and welcome to the MarketAxess second 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. 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, 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 second quarter 2012 results. This morning we released solid second quarter financial results in spite of industry-wide headwinds during the quarter. Revenues of $48.8 million and pre-tax income of $21.2 million were both 7% above the second quarter of 2011. Diluted EPS improved to $0.34 compared to $0.30 one year ago.

Despite the softer overall market volumes, we feel very good about the progress made during the quarter. Our estimated US high-grade market share accelerated to a record level of 12.4% compared to 11.1% in the second quarter of 2011. Emerging markets and high-yield volumes were both up over 25% and reached record levels during the quarter. Importantly, we continued to deliver new electronic trading solutions to help our dealer and investor clients interact with new counterparties and develop new sources of liquidity.

Slide 4 displays some details on our quarterly results and financial strength. Solid revenue growth in the quarter was the principal driver of the growth in pre-tax income to $21.2 million. EBITDA was up 8%, to $23.2 million, versus the second quarter of 2011. Operating and EBITDA margins were 43% and 48%, respectively.

Free cash flow and a strong balance sheet have allowed us to return cash to investors through share repurchases and growing dividends. Our cash and securities balance at June month end was $188 million, or $5.03 per diluted share. The Board has approved a regular quarterly dividend of $0.11 per share.

Slide 5 provides an update on market conditions. Credit concerns reemerged in Europe during the quarter, and market volumes across products were softer than the first quarter averages. For the first half of 2012, high-grade TRACE is on pace for $3 trillion in annual volume, flat to 2011.

Inflows into bond funds remain strong in spite of the decline in new issuance and flattening of the yield curve. Block trading, or trades of $5 million or more, continues to trend lower as a percentage of overall high-grade TRACE volume, as primary dealers operate with much smaller market-making balance sheets.

Block trades represented 38% of total TRACE volume in the second quarter, down from 45% in the second quarter of 2011. Smaller trade sizes, where we typically have a higher market share, continue to make up a larger percentage of TRACE.

Slide 6 summarizes the trading volume across our product categories. Overall global volume in the second quarter was up 9% year over year to $145 billion. Q2 high-grade TRACE volumes were flat compared to a year ago, and the 12% increase in our US high-grade volume to $91 billion was due solely to market share gains. A 24% increase in investor orders versus the second quarter of 2011 drove the market share gain.

Euro bond volumes were down 22% from the second quarter of 2011 to $7.8 billion. Volatile credit spreads and investor risk reduction in Europe have caused market volumes to decline. Our cross-regional business from European investor clients into emerging markets and US high-grade bonds grew 46% from the prior year period, offsetting the volume decline in Euro bonds.

Other product category volumes were up 10% from the second quarter of 2011 to $46 billion in the second quarter of 2012. As mentioned earlier, growth in high-yield and emerging markets drove the increase in the other product category.

Slide 7 provides an update on regulatory activity. New regulations are having a far-reaching impact on the way bonds and swaps trade. Basel III capital requirements, the proposed Volcker rules, and Dodd-Frank are driving a number of important market changes. Primary dealer market-making balance sheets are declining due to an increase in capital requirements, leading to a reduction in block trading. New non-bank-affiliated dealers are increasing their capital commitment to market-making and increasing their market share. Electronic trading is growing in credit bonds and CDS. Dealers and investors are seeking increased electronic connectivity to develop new sources of liquidity.

In CDS, we currently expect the CFTC to finalize SEF rules and implementation schedules in the third quarter. The FTC has not yet published a timetable for securities-based SEF rules, but we would expect the FTC rules for single-name CDS to slip into 2013. We are investing heavily in CDS trading functionality and clearing connectivity to prepare to register as a SEF. While still in early days of adoption, our efforts paid off during the second quarter, with CDS trading volume on the system up more than 150% versus the first quarter. We are seeing growing participation from dealers and investors.

Slide 8 gives an update on our new initiatives. We have expanded our suite of electronic trading protocols to help investors and dealers more effectively source liquidity in the credit markets. With our enhanced Market List functionality, investors can now display any live order anonymously to the entire MarketAxess institutional community, consisting of over 1,000 investor and broker-dealer firms.

Over 32,000 orders were submitted to Market List during the second quarter. We have a defined roadmap to roll out additional trading protocols and functionality to increase order matching opportunities for investors and dealers. Demand for these new solutions is running very high.

As announced yesterday, we have developed the industry's first anonymous request-for-quote trading protocol for credit markets on DealerAxess, our dealer-to-dealer electronic trading platform. Over 100 dealers are participating, and more than 5,000 trades have been executed since the anonymous functionality was introduced two months ago.

These new products, client segments, and trading protocols, combined with the strong results in our core products, demonstrate the growing opportunity set we see for MarketAxess in global electronic credit markets.

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 9 displays our quarterly earnings performance. Revenues of $48.8 million were up 7% from a year ago, driven principally by growth in variable transaction fee commissions. The year-over-year decline in technology products and services revenues was due to lower professional services fees.

Total expenses were $27.6 million, up 7% from the second quarter of 2011, and pre-tax income was $21.2 million, also 7% above last year. Our year-to-date incremental margins were 63%. This means for each additional revenue dollar generated, approximately $0.63 fell to the operating income line.

Our year-to-date effective tax rate is 40.6%. We are trending toward the higher end of our 2012 tax guidance range due to a decline in foreign source income. Our diluted EPS was $0.34 on 37.4 million diluted shares. The second quarter diluted share count reflects the full impact of the share repurchases completed in the first quarter of 2012.

On Slide 10 we have laid out our commission revenue, trading volumes, and fees per million. Distribution fees were $14.3 million during the second quarter of 2012, down 8.5% from the second quarter of 2011 and 11% from the first quarter. The $1.8 million sequential decline is consistent with the guidance provided on our first quarter earnings call. We currently expect that third quarter distribution fees will be consistent with the second quarter level.

US high-grade fees per million were $202 in the second quarter, up from $184 in the second quarter of 2011 and $188 in the first quarter of 2012. The sequential change was primarily due to a combination of an increase in the duration of high-grade bonds traded and greater impact of the execution fee from the all-variable dealer plan.

The other product category fees per million were $205 in the second quarter of 2012, up from $182 a year ago and consistent with the first quarter of 2012. The second quarter volume mix in the other product category, which consists of emerging markets, high-yield and agency bonds, was largely consistent with the first quarter.

Slide 11 provides you with the expense detail. The 7% year-over-year increase in total expenses is in line with our five-year compounded annual growth rate and driven by a combination of expense growth in core products and investment in new initiatives. The sequential quarterly decline in employee compensation and benefits is mainly due to seasonally higher payroll taxes in the first quarter and a lower incentive bonus accrual, which is tied directly to operating performance.

The expenses for the first half of 2012 were $55.6 million. Our full year 2012 expenses are trending toward the higher end of our original guidance range of $107 million to $112 million.

On Slide 12 we provide balance sheet information. Cash, cash equivalents, and securities available for sale as of June 30 were $188 million, compared to $248 million at year end 2011 and $211 million one year ago. Cash returned to shareholders through share repurchases and our quarterly dividend over the past 12 months amounted to $94 million and was mostly funded by free cash flow generated over that period of $64 million.

Capital expenditures, which include computer software and equipment, together with capitalized software development costs associated with trading platform enhancements and new products, totaled $3.6 million for the first half of 2012.

As mentioned on our year-end earnings call, we're in the process of building out a replacement disaster recovery data center. We expect that capital expenditures will increase in the second half of the year and believe that our full-year capital expenditures are trending towards the high end of our original guidance range of $8 million to $11 million. There was no change in our capital structure during the second quarter, and we continue to have no bank debt.

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

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

Thank you, Tony. Our second quarter results show a solid growth in core products and positive progress in developing new electronic marketplaces. We believe that we have the right trading network and technology capabilities to provide a full menu of liquidity solutions to address today's changing credit market structure. We are excited about the opportunities ahead.

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

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions.) Howard Chen, Credit Suisse.

Howard Chen - *Credit Suisse - Analyst*

Rick, just wanted your latest thoughts on competitive landscape. Over the years, you've been really consistent in saying that any electronic offering that comes to this market is ultimately good and validation of the MarketAxess business model. But it does look like maybe you're becoming like more in direct competition with some of these new offerings that we read about. Would you agree with that statement, and is there any different sense or evolution of the thinking on competitive landscape from your perspective?

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

Not really, no. I think what you see from some of the new initiatives is a desire to promote investor-to-investor order matching, especially in larger trade sizes. And that is where there is strain in the secondary markets today, and you can see that through the decline in block trading that is coming through on a quarterly basis in high-grade.

And I think when we look at these initiatives, it does validate that there is a desire for more electronic connectivity in the market. We need to keep building new solutions, which we are confident that we are doing. And I think you see a core belief here that while investor-to-investor order matching can complement dealer liquidity, it will never replace it.

And where we are going, Howard, is to really make sure that we have a full suite of electronic trading solutions that promote not only investor-to-investor order matching, but investor-to-multidealer and now, increasingly, dealer-to-dealer so that we can help all clients move bonds through the market more quickly and efficiently.

And as you're well aware, during the quarter, investor-to-investor matching has certainly made for some interesting headlines. But when you really get into the facts in the secondary market for credit, there's a limit to the amount of investor matching that could conceivably take place. And specifically, when we look through our TRACE and the customer buys and sells on a daily basis, we estimate that if you had access to 100% of the investor orders during the day, you could match approximately 12% to 16% of high-grade TRACE volume.

And I think this reflects the challenge in the market, which we also think supports our strategy, that we need solutions across every possible client segment to promote more liquidity in the markets. So I do think that the world is changing and people are going to try different things. What we're seeing from our investor and dealer clients, broadly based, is full support for the direction that we are taking, the independence of the Company and the size of our network, and we think we're on the right track.

Howard Chen - *Credit Suisse - Analyst*

Great. Thanks for all those thoughts. And then a second one for you, Rick, just a nice expansion within the US market share. I'm curious if you have any thoughts about how much the share gaining is secular trends as in more electronification, increasingly constrained dealer balance sheets, and how much of this is maybe cyclical, that the Company gets a bit of a rebound when issuance levels are low and overall liquidity is low within the broad US high-grade industry?

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

Yes, there's definitely a cyclical nature to the quarterly share, Howard, as you know, where typically the fourth quarter is very favorable for electronic share, and the first quarter, where you have very heavy new issuance, tends to be slightly softer. But I think anyone looking at the last three years of share gains would say that there's a meaningful and sustainable increase in electronic market share taking place in credit.

And I think the second quarter was another great data point. And as we pointed out earlier this morning, the 12.4% share during the second quarter compares quite favorably to the second quarter of last year. And that trend's been with us now, really, for three straight years coming out of the credit crisis.

Howard Chen - *Credit Suisse - Analyst*

Great, thanks. And then finally for me, Rick, the 150% growth in CDS volumes -- I realize we're probably talking about growth of a very modest base. But could you just provide a little bit more detail about where that growth is coming from, how the flow has maybe changed since you've launched the offering, and what does 150% growth in volume translate into revenues and earnings? Thanks.

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

Yes. And just to repeat, we are not currently charging transaction fees in the CDS platform, so it has no current impact on revenue or earnings. But we are seeing very good signs of growth in participation in our CDS platform from both dealers and investors, and we're seeing growth in activity, and it's becoming more consistent on a daily basis.

And what differentiates our offering, we think, from the others in the marketplace are the breadth of the solutions that we provide, where each quarter we're adding new functionality and we're now trading, not only in the index markets, but we're also trading in the single-name markets. We have completed our connections to both ICE and the CME for central clearing. We've added limit order capabilities to the platform. We have both request for quote and multi-dealer streaming protocols. So we feel very good about the developments, and we think it's starting to come through in the increase in trading activity on the platform.

Howard Chen - *Credit Suisse - Analyst*

Perfect. Thanks for taking all the questions.

Operator

Patrick O'Shaughnessy, Raymond James.

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

First question, going back to the competitive landscape question that Howard had. So when we read stories about the buy side (inaudible), the sell side in Boston and trying to come up with a new system, how much should we read into that, that the buy side is not satisfied with the MarketAxess solution versus some other trends that might be taking place that you think are an opportunity for you guys?

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

Yes, I think that the growth in buy side participation and share on MarketAxess reflects their satisfaction with the service that we are providing. Having said that, Patrick, with 12.5% of the market now on MarketAxess, investors are still trading 87% of their volume the old-fashioned way, and much of the interest in meeting with dealers is to talk about the changes that are taking place in dealer balance sheets and how investors and dealers can work together to develop new solutions.

And much of that feedback, whether it's from investors or dealers, is coming directly to us. We've had many, many meetings during the quarter, both individually and with groups of investors, about the new solutions that we are delivering. We've been taking their input on a regular basis. They are defining our roadmap for the next three or four quarters. And we also work very closely with the dealer community. So I think what it reflects is that there is a shift in market structure taking place. As a result, some new enhancements and solutions need to go to work, and we're very pleased with the amount of interest that we're getting directly to MarketAxess in jointly developing those solutions with investors and dealers.

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

Okay, that's very helpful. Thank you. Second question, touching on revenue capture, to what extent do you guys think that these trends that you've seen are sustainable? My guess is the component of the dealers moving from the fixed rate to the variable-rate plan, that's probably going to stick, it seems like. But how confident are you that the duration-aided benefit that you guys are experiencing is going to be sustainable?

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

Patrick, it's Tony. On the US high-grade fees in particular, there's a lot of different variables in there. It's not only duration-dependent, which is influenced by years to maturity and yield, we also have within our plan, there's a tiered plan based on volume so that the larger the trade size, the smaller the fee. And also, that dealer mix does influence it, just the mix between the all-variable plan and dealers on a major plan. So you've got a bunch of different variables there.

And I'll just tell you, you look sequentially, that we did have a sequential increase in the fee capture, and it was almost equally split between duration impact and the execution fees. So they both equally contributed to the increase.

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But you look out from where we are today, and can we maintain that current level? Certainly, with what's coming out of the Fed in terms of keeping rates low, we can at least see that in the near term is that will be the case.

The yield curve has definitely narrowed over the past 12 months. It's probably come in 150 basis points between the 10-year and the 3-month. So that yield curve's narrowed. It really has not influenced the years to maturity. And as a matter of fact, years to maturity actually extended slightly in the second quarter. And even though those dealers on the all-variable plan, we haven't seen a significant movement in the percentage of their volume, but the execution fee is still contributing significantly to that fee capture.

So I guess it's a long-winded way of saying there's lots of variables. It's tough to predict. In the near term, it seems like it's sustainable. You'd have to have a, from here on forward, a marked movement, say, in years to maturity, more than anything else at this point in time, to bring down that fee capture.

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

Got you. Thank you. And then if you can remind me, as far as revenue capture, specifically on the high-yield, is there an element where you guys -- all else equal, you get paid less for lower-rate bonds?

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

This is on high-yield, Patrick?

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

Yes. Oh, sorry, on high-grade.

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

So on -- could you just repeat the question?

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

So I guess the question is, I think there's a couple of elements to your revenue capture on high-grade. One is the duration of the yield to maturity -- the longer duration, you guys get paid more. I think if I recall correctly, there's also a second element, which is the higher rate that is on the bond, the more you guys are going to get paid. Is that correct?

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

Yes, so we've got a, it's a tiered plan. When I say tiered, so it's tiered based on trade size. So the smaller the trade size, the higher our fee. So our fees are designated on high-grade, it's in yield spread over the underlying Treasury, and it does range from 0.5 on the high end with a smaller trade size to 0.1 on the low end. It typically averages about 0.2 of 1 basis point. But yes, because we have this tiered plan based on trade size, the smaller the trade size, the higher the fee capture.

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

Okay, that's helpful. Thank you. And then lastly, just touching on your expenses, you said that it looks like you're running towards the high end of your guidance. Are you sticking by your guidance for the full year?

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

Yes, we're still sticking by the guidance for the full year. It's just, when you look at the first half of the year, we were at $55.6 million. There will be, or at least we're expecting, is just a moderate increase in expenses in the second half of the year. And even if you just pick the second quarter as the run rate for the second half, you'd be closer to $110.5 million or $111 million. So we just, right now, sitting here, it does feel like we'll be more toward that higher end of the range, but still within the $112 million upper end of the range.

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

Okay, that's helpful. Thank you.

Operator

Matthew Heinz, Stifel Nicolaus.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Given the new anonymous trading protocols that you're rolling out and introducing, and also the well-known problems that are facing the buy side in block liquidity and cross-matching, what issues, other than maybe just familiarity, do you think would prevent clients from turning to MarketAxess increasingly as a solution to execute more of that 12% to 16% that you cited as the market as cross-matching potential?

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

I think it's just continuing to deliver the various matching solutions that the buy side thinks could be viable. I do think, Matt, that we have a terrific head start in this. We've been fast at work on bringing new investor clients onto the MarketAxess system for the last 12 years. We have close to 300 of them that are directly integrated into the system with their STP and order management systems, and they are very familiar with the technology and the trading platform. So we think we're in a great place to continue to be the platform of choice as investors look for new matching protocols to complement the existing liquidity that they have in the marketplace.

And I don't really see any obstacles. In fact, from what we've seen so far, we do have enthusiastic support in the meetings that we've been holding with a variety of different investors.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Okay, that's great. And then just piggybacking on that question, have you seen any dealer pushback towards your promotion of Market List and some of the other efforts to encourage more client-to-client matching?

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

The answer to that is really no. I think the dealers are as aware as anyone that market structure is shifting. Dealers need to operate in different ways. We have worked in all of our solutions to be inclusive of dealers and investors, because ultimately, we think that will create the best liquidity solution.

So in no way are we trying to go around the dealers, because we don't think that would be particularly successful over time. So we're working very closely with them. They're well aware of our strategy and what we're doing. Some of them are offering clients various ways to get orders to them as well, and I think that reflects their recognition that the business model is changing.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Okay, that's very helpful. Thank you.

Operator

Hugh Miller, Sidoti and Company.

Hugh Miller - *Sidoti & Co. - Analyst*

I guess one question I had I didn't catch, did you guys comment on initial expectations for July market share?

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

No, we didn't, and you and others criticized us for misguiding you because we said something last quarter when we still had five days of trading left about we actually outperformed expectations because of those last five days.

Hugh Miller - *Sidoti & Co. - Analyst*

I didn't criticize you.

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

The first thing we would say is that we do have five important trading days still left in July -- and probably especially important this month, Hugh, because the Fourth of July week was a very soft week across markets because of the fact that the holiday fell right in the middle of the week. So our guidance to you right now would be that, based on what we see so far, we would expect July's share to be above the second quarter levels, but we do have five important days of trading still in front of us in the month.

Hugh Miller - *Sidoti & Co. - Analyst*

Okay. And would you also anticipate that you probably get back a touch of the gains that you enjoyed in June?

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

Can't really comment on that just yet, with those five important days still remaining.

Hugh Miller - *Sidoti & Co. - Analyst*

Okay, okay. And I guess another question I had is if you take a look at the industry trading volume on an average daily basis, TRACE trading was somewhat sluggish in June compared to the prior June. As you look at the trends, and obviously, as you mentioned, we've got some important trading days left, but as you look at July, it is trending down again on an average daily basis. Can you just talk about why you think that that might be for the last couple of months, just given that we are still seeing solid inflows into taxable funds?

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

Hugh, when we look at trades volumes and you look at the first half of this year compared to the first half of last year, it's almost identical. The same thing within the quarter. The second quarter was virtually identical to the second quarter of last year, albeit off 15% from the first quarter, which was at record levels.

And even when we look at July, and Rick mentioned that first week was really a killer, when we look beyond the first four trading days, which is in, say, the past four years, the only time we had a midweek holiday, we look beyond those first four trading days, and the TRACE volume is spot-on with the prior three years. So if you look at, say, July in isolation, the July average daily trading volume the last three years is right around $11 billion. If you take out the first four trading days, again, which were a killer, take out the first four trading days in July of this year, it's a little north of $11 billion. So we're not seeing it fall off, again, if we exclude those first four days.

So Rick made some, in the prepared remarks, some comments about trending towards $3 trillion for the full year. Again, without having the ability to forecast TRACE with any real accuracy, we're still seeing that trend right now.

Hugh Miller - *Sidoti & Co. - Analyst*

Sure, and I understand that over, you take a look at the half, it looks a little bit differently. But when you look at it for June and July, and it's good color that you provided in July, being that the holiday fell midweek, so that may have influenced it more than it normally does. But you just look at it for the last two months, it's just been a challenge. And I know that if it wasn't the case for your trading activity in June, that you saw a tremendous market share growth. But I appreciate the insight there.

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

Yes, and just to expand on Tony's comments, the holiday impact this year, with the Fourth on a Wednesday, was really a four-day impact. And when we looked at the prior Julys, it was maybe one or two days. And I assume, Hugh, that you're seeing that across other asset classes, too, just highly unusual, with that holiday sitting right in the middle of the week.

Hugh Miller - *Sidoti & Co. - Analyst*

Sure, sure. And another question I had was if you can give us an update on your efforts to leverage your transaction cost analysis with clients. Obviously, you saw a nice year-over-year improvement in inquiries, but what's the feedback you're getting from clients that you are sitting down with? How many, to this point, have you been able to work with, and how many more are on the plan for the rest of the year or next year?

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

It's now become, really, part of our quarterly work with investor clients, both those that are using the system actively and those that are using it less than others. And it's been very well received. I think they feel that the analysis is done in a professional and credible way. We do think that that is one of the key drivers that is continuing to move our market share up.

And it's reflected in the significant increase in investor order flow that we reported this morning, with orders up 24% from a year ago. So I think the transaction cost savings are a key part of the value proposition that we are delivering to investors, and all signs are that that's one of the components that's helping us drive the share higher.

Hugh Miller - *Sidoti & Co. - Analyst*

Okay, so is it safe to say that since you're already incorporating that with your quarterly reviews, that a good portion of that benefit is already now worked in, because you've had a chance to review that analysis with the majority of your clients?

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

I think that the work is more familiar to people. We still see investors at various stages of adoption around electronic trading. And I think what the recent press has done is it's refocused everyone on the benefits of electronic trading, and some of that is clearly accruing to us. So the work is out there. Is the full benefit being reflected in the potential yet? We don't think so, but we think we're moving in the right direction.

Hugh Miller - *Sidoti & Co. - Analyst*

Okay. And another question I had was, as we think about the focus on growing the dealer-to-dealer trading, how does the pricing in that product compare to client-to-dealer, and how should we be thinking about that?

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

Hugh, right now it doesn't vary significantly from what you're seeing on the client-to-dealer side. And it's a little bit of a nuance here, because in that case, we're a counterparty to both sides of the trade, so as is the norm, we are reporting both sides of the volume. So I think if you looked at it as a single trade, the pricing would be higher. But when you count both sides of the volume, it looks similar right now to the client-to-dealer pricing, in that $200 per million range.

Hugh Miller - *Sidoti & Co. - Analyst*

Okay, okay. And then the last question I had was just with regards to the share buyback authorization. I know you still have a little bit remaining that you have been using, but given the pullback we've seen in the stock, is there a changing sentiment there to revisit share buyback and potentially increase the authorization?

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

Hugh, at this time the Board didn't take any further action to increase that buyback or what's remaining under the buyback. And it's really, when you look at what we did back in the first quarter in terms of big block repurchase with JPMorgan, they just didn't feel it was necessary at this point in time.

Having said that, we did suspend the repurchase plan in connection with the JPMorgan offering. We still have $10 million remaining authorized under that plan. And while we didn't make any repurchases under the plan in the second quarter, we're still free to utilize that authorized amount.

But the Board, again, at this point in time, they did look at regulatory and working capital requirements. We're closer to the SEF rules, so we'll have more visibility on the SEF capital requirements. There are some investments we're making, obviously, in these organic initiatives around CDS and D2D and open trading and international expansion. So in light of all that and in light of what we did in the first quarter, they just didn't take any further action right now.

Hugh Miller - *Sidoti & Co. - Analyst*

Okay, appreciate the thought. Thank you.

Operator

Niamh Alexander, KBW.

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

The credit derivatives businesses -- should we still think about maybe you as targeting more of the single-name credit default products rather than the indices, which it seems like the regulators would very much like to guide the indices more towards exchange-type venues. In that case, that's the SEC, right, who you're signaling as probably going to be 2013 before they approve the SEF stuff. Is that fair?

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

Yes, that's our best sense right now, and I think there were two different questions there, Niamh. One is about our focus in CDS, index versus single name; and then, two, about the regulatory path. And we're focused on delivering the broadest CDS product offering which we ultimately think will serve our dealer investor clients the best. So you do see us out ahead in functionality that addresses both index and single-name trading today.

When we get into single-name trading, the liquidity dynamics of single names look more similar to corporate bonds than what you would see in a highly liquid index, and that's why we think some of our technology and network advantages will come through most clearly in single names.

Based on what the commissions have been saying, we do expect that the CFTC is very close to finalizing their SEF rules, and we would expect those rules to be out this quarter. So we'll get more clarity on the trading protocols, on the implementation dates, et cetera, that are important on index regulation. From what we can tell -- and again, this is just our best guess, and all of you have your own sources as well -- but it would appear that the SEC is probably about six months behind that timetable, which is why we said this morning, if we had to guess, we think the security-based SEF rules are more likely to come out in 2013.

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

Okay, fair enough. I'm able to see the clarification. The other thing, I guess we've seen your stock, and I felt it was taking a hit as these competitive news headlines were coming out. But there's almost like two different markets in the corporate bond world, where you have the block trades happening, and then you have the non-block, which is your core business. And it seems like the industry's really struggling and looking for solutions for the block trades and the big size trades. But your stock still gets hit every time there's an announcement or a discussion, even, of the competitors.

Am I understanding it correctly, that right now the struggle is finding liquidity for the bigger size trades and finding a solution for those? And while you absolutely have functionality to participate in that, that's still not the core, the majority of what you do today?

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

I think that's right. What we're excited, when you look at block trading, the nature of block trading is changing. More of it is shifting into what people traditionally think of as our sweet spot, in $1 million to $5 million trade sizes. And undoubtedly, that's another factor that's driving our share higher.

But when we think about some of the anonymous order-matching capabilities that we have started to deliver and the plans that we have over the next two or three quarters, we think we've got some really interesting solutions to participate in more block trading business, too.

So what this really reflects is I think that all three major segments of TRACE, whether it's D2D, block trading, or the $5 million and under client-to-dealer business, all have greater potential for electronic trading. And we think we are the best positioned to deliver the solutions across all three of those segments of TRACE, and I think this quarter is a great sign of support and validation for some of those new initiatives which, to us, increase the size of our addressable market.

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

Okay, fair enough. Thanks, Rick. And then on the dealer-to-dealer thing for the new data point service, as you said, like over 32,000 orders submitted. Can you help me understand, is the hit rate improving? Is the match rate improving? Because if the traders don't get the hit and the match, then eventually they give up putting in the orders, too. So are you seeing a notable improvement there? Are you seeing a notable level of hit rate there that you could share?

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

Yes, I think you said D2D first, but it sounds like you're asking about Market List, right?

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

Okay.

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

Yes, so so far the hit rates are still pretty low. But this is a multi-pronged process to get to the point where more matching could take place. The orders coming in is a great sign to us, and we are starting to see some clients default to making all of their MarketAxess lists publicly available through Market List. We are also seeing a lot of take-up in more investors setting up watch lists to match the bonds that they are trading and most interested in, which will then create alerts for them when other investors are in the market trading those bonds. So we think we're on the right buildup here. We have people thinking about creative ways to use Market List to encourage more investor-to-investor matching.

On the D2D side, since you gave me a small opening there, too, initially, if you look at it, at our D2D platform, we have almost double the number of dealers participating in our dealer-to-dealer system than we do in our client-to-dealer high-grade platform. And what that really reflects is that we're starting to connect the institutional dealer market to the retail dealer market, and we're providing a valuable service in terms of allowing the large dealers to move inventory items off of their balance sheet more quickly and get those bonds out to regionals that might be servicing retail customers or very small institutions. That's also part of the new market structure, because if we can help those dealers to clear capacity on their balance sheet through our D2D solutions, it's then going to free up more capital to go back to work in our institutional system with institutional investor orders.

So in our mind, all three of these things are really interconnected, and that is why we're excited about the unique position that we have to provide solutions across all of these different parts of the market.

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

This is very helpful. Thanks, Rick. And then I guess, just lastly, the international office's expansion you had kicked off in Latin America, initially you were trading the international product, but now you're also going to be trading the local product locally. What are the plans for Asia? Are you plowing ahead with that, or are you going to take it a little bit more slowly there?

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

Yes, we are still doing all of the work around expanding our EM local market capabilities. We are seeing nice take-up in terms of new Latin American clients coming on the MarketAxess platform, and we're getting more local market debt trading done in both Mexico and Brazil. We really want to see those efforts paying off with validation from the market, but at the same time, we are studying additional EM local markets. And some of those, as you point out, are in Southeast Asia.

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

Okay, sorry. I said last, but one more. And the access fees -- have you explicitly changed your fee levels at all over the past quarter?

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

No, Niamh. So we haven't changed the fee schedules. We did have that fee change in Europe back in the first quarter, but no, we haven't changed the fee schedules. And even when you look through that other category-- I know it gets a little muddied up when we have three different principal products in there -- the fee capture individually for emerging markets, high-yield, agencies did not swing, really, with any significance, quarter to quarter, year over year. And no, we have not made any fee plan changes in the second quarter.

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

Okay, great. Thanks for clarifying.

Operator

Justin Hughes, Philadelphia Financial.

Justin Hughes - *Philadelphia Financial Management - Analyst*

I just wanted to follow up, actually, on one of Hugh's questions when he was talking about the weak start to July, although you gave some good explanations on why it could pick up. But if historically, we've seen in quieter periods, you've picked up market share; in the real volatile periods, market share has maybe pulled back. Do you think that's still the case, or is that from dated in years past, and you should be a more net market share grower consistently?

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

Justin, where we've seen, at least in recent times there, we've seen pockets where our market share has slowed down, it's been in those times where there's been a significant imbalance in orders. So when you look, say, at February of 2012, October 2011, those are periods where there was a big imbalance in the market, and in particular favoring the offer side at a time when dealer balance sheets are at these all-time lows. So that, probably more than anything else, influences, at least from the market share side. It's really that bid-offer mix and the big imbalance that could take place.

Justin Hughes - *Philadelphia Financial Management - Analyst*

Okay, and you don't see anything like that currently, correct?

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

It's interesting you'd say that, because at least in July to date -- and again, five important days left -- at least what we're seeing in terms of order flow, there is a bit of an imbalance that looks similar to that February and October timeframe, where it's more of, say, a 60/40 split, offers to bids, which in a more historical context, would be more challenging from a market share standpoint. But as Rick said right now, our market share for July is trending above the second quarter level. So we'll see what happens in the next five days. But July is, at least right now, is looking like one of those imbalance order type months.

Justin Hughes - *Philadelphia Financial Management - Analyst*

Is your read-through that it's from maybe some of these large investment banks that have announced new initiatives to try to lower their leverage and take down their balance sheet? I think Deutsche Bank, just yesterday or the day before, said that they're going to try to reduce leverage more. Morgan Stanley said they were going to reduce their FIC exposure. Is that what you would read through on that?

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

It is what I would read through, is I think that they're looking for additional ways to participate in client orders while still operating with smaller balance sheets.

Justin Hughes - *Philadelphia Financial Management - Analyst*

Okay. And then related to that, if it does end up being a slow second half to the year, would you rethink your expense guidance, or are you wed to that because of the initiatives you have?

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

Justin, there's still some variability in that expense number for the second half of the year. And if market volumes continued to trend lower -- let's take that sort of scenario -- we do have a pretty big element of our expense base which is variable. And in particular, that's our variable bonus incentive scheme, which is tied directly to operating performance. So in the natural course, if you did see a drop in overall market volumes, and even with an increasing market share, a drop in revenues for us, there would be a natural decline in expenses vis a vis that incentive bonus.

Justin Hughes - *Philadelphia Financial Management - Analyst*

Okay. Thank you.

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

I think, just expanding on that a little bit, Justin, given the number of large opportunities that we see in front of us in bonds and in CDS, I don't think you should expect us to radically change our investments during the second half of the year. This is a time where we want to be expanding our capabilities to address the long-term opportunities. And while there is some natural variability in our expense base that Tony pointed out, we are committed to making the investments in the solutions that the market really needs to address the changing market structure.

Justin Hughes - *Philadelphia Financial Management - Analyst*

Okay. Thanks again.

Operator

Patrick O'Shaughnessy, Raymond James.

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

Hey guys, a couple of quick follow-ups. On the dealer-to-dealer, are you able to quantify what percentage of your volume at this point on the high-grade is dealer-to-dealer?

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

Patrick, we're not disclosing that separately, but I will tell you it's a very small, almost negligible, portion of our market share. And just to put it in context, if you look at overall second quarter market share, 12.4%, it was about 0.2 of 1% is what it accounted for.

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

Okay, thank you. And then on the CDS, you talked about how you're not charging for it right now. Do you have a timeline that you're willing to share in terms of when you think you'll be at a point where you're ready to charge for that?

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

We do not have a stated timeline on that. We've said that, with the costs involved in operating a SEF, we would expect that transaction fees on CDS are likely to come into play around the time of implementation of the new regulatory rules, but we have not stated any official timeline on that.

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

Okay, thank you.

Operator

(Operator Instructions.) Matthew Heinz, Stifel Nicolaus.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Hey, guys, just a quick follow-up on the capture rates in the other segment. It looks like you're trending towards all-time highs there, up quarter over quarter. Can you just speak a bit on the changes in mix shift and whether the shift towards more emerging market and the high-yield is continued in the third quarter? And then also how much impact has the elimination of CDS volume reporting had on those metrics?

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

Matt, on the very last point in terms of the CDS impact, really negligible, if any impact. So, as Rick mentioned, we're not reporting CDS volumes in there. And even when we looked at it year over year, where there were some CDS volumes in the second quarter of last year, it's a negligible impact.

What you've seen here, and Rick mentioned in the prepared notes, we've got EM and high-yield volumes continuing to grow at a pretty healthy pace, both north of 25% year over year. And we've had, really, a moderation on the agency side. So we're not seeing the type of growth in agency bonds that we saw in 2009, 2010, and 2011. So that mix has shifted. And just to put it in a little bit of context, if you went back to last year, say, the second quarter of last year, it was probably closer to a 50/50 split if you took agencies compared to emerging markets and high-yield combined. So about a 50/50 split.

And then you fast-forward to the second quarter of this year, and it's closer to, say, 57% or 58% is in emerging markets and high-yield, and agencies is the residual. So you've seen this shift again, really, around a moderation on the agency side, and a continued growth in high-yield and emerging markets.

Matthew Heinz - *Stifel Nicolaus - Analyst*

Okay, thanks very much.

Operator

(Operator Instructions.) We show no further questions at this time, so I'll now turn the call back over to Rick.

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

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

Operator

Thank you, ladies and gentlemen. This concludes today's conference. Thank you for participating. You may now disconnect.
