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Investment Technology Group, Inc. (ITG)

Q1 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning, and thank you for joining us to discuss ITG's First Quarter 2014 Results. My name is Maurine, and I will facilitate the call today. After the speakers' remarks, there will be a question-and-answer period. I will provide further instructions before we take questions. As a reminder, this session is being recorded.

And I would now like to turn the call over to Mr. J.T. Farley of ITG.

James T. Farley
Head-Investor & Media Relations, Investment Technology Group, Inc.

Thank you, Maurine, and good morning. In accordance with Safe Harbor regulations, I would like to advise you that the forward-looking statements we will be making this morning are subject to a series of risks and uncertainties that may cause actual results to differ materially from those statements. These forward-looking statements speak as of today, and you should not rely upon them as representing our views in the future.

While we may elect to update these forward-looking statements in the future, we undertake no obligation to do so. I advise you to read about the risk factors that may affect forward-looking statements in this morning's press release, as well as in our SEC filings.

I would also like to point out that we will be referring to non-GAAP financial measures in today's presentation. Reconciliations of these non-GAAP measures to the comparable GAAP measures can be found in this morning's press release, as well as the press releases covering prior earnings periods.

Press releases and the PowerPoint slides, which accompany this presentation, are available for download in the Investor Relations section of itg.com.

Speaking this morning are ITG's CEO, Bob Gasser; and CFO, Steve Vigliotti.

To start, I would like to turn it over to Bob.

Bob C. Gasser

President, Chief Executive Officer & Director, Investment Technology Group, Inc.

Thanks, J.T., and thank you all for joining us to discuss ITG's first quarter 2014 results. We are pleased with our overall performance, as a second straight quarter of record revenues in Europe helped drive our earnings per share to the highest level in more than four years. We believe our results continue to reflect our strategy of establishing a truly global set of product capabilities, while maintaining cost discipline across our platform.

Before I discuss our results, I'd like to briefly address the debate which is now raging around the current state of equity market structure and financial regulation. This debate may have increased in volume recently, but it is not new. ITG has been an active participant in this debate and often a disruptor in the market since POSIT launched in 1987.

We welcome dialog with our clients, regulators and other market participants, and believe that a thoughtful data-driven approach is the best way to tackle problems in an increasingly complex market structure. We encourage our clients to ask questions of us, and of all of their brokers, to ensure that we are truly working in their best interests in mind and striving for best execution.

Towards that end, we've launched a new section on our website this morning devoted to execution transparency, which highlights the different insights available to our clients, including detailed, granular execution reports and our Algo Prism real-time execution monitor, which provides visibility into the activity of each ITG algorithm, such as predicted and realized execution schedules, fill details and the location, type and price of every open order.

We've also provided more detail on our flagship crossing network, POSIT, including the Form ATS, which we file with the SEC, and a plain language guide to executions in POSIT. We hope that these materials will help educate our clients about how we work on their behalf.

Turning now to our first quarter results, revenue grew 4% over last year, driven by strong growth in our international segment, including another record quarter for Europe. The international strength more than offset a slowdown in the U.S. Equity fund flows were positive with an estimated $54 billion flowing into U.S. and international active equity mutual funds, according to ICI.

The average daily volume of combined New York Stock Exchange and NASDAQ-listed volumes rose 6% over the first quarter of 2013, while ITG's average daily volume actually fell 15%. As we've said previously on many earnings calls, gross market share is an imperfect gauge of ITG's U.S. business, since our volumes are predominantly institutional. And overall market volumes are heavily influenced by other factors, such as the amount of retail and high-frequency trading in the mix, as well as the current resurgence of initial public offerings, which provides a near-term competitive advantage to firms with strong deal calendars.

Despite the headwinds, our average U.S. revenue per share rose year-over-year from $0.0046 to $0.0047, even as the percentage of sell-side volume rose to 51% from 49% in the first quarter of 2013. We continue to focus on maintaining and growing our average buy-side commission rate by offering premium products to our clients, such as ITG Investment Research and POSIT Alert buyside block crossing.

POSIT Alert saw an increase in block size during the quarter, with average trade size standing at 35,000 shares. Overall volume executed in Alert dipped by 5% year-over-year, but it was up 22% sequentially. While conditions in the U.S. are still somewhat challenging, our efforts to control costs helped improve earnings. Despite flat revenue sequentially, we were able to improve net income through a 5% reduction in costs. We believe our competitive position in the US remains strong, and the results of the latest Greenwich Associates report on electronic trading bear this out.

The report, which is the most comprehensive survey of its kind in the industry, found that ITG ranked number one for overall electronic trading quality among investment managers; number one for domestic portfolio trading; and number two overall in share of algo trading and dark pool crossing. ITG was also ranked at the top for best protection against toxic activity, which speaks to the strength of our commitment to best execution for our clients.

Turning now to Europe, our revenue in the region grew 57%, while the profit contribution from the region more than tripled compared to the first quarter of 2013. While some of the improvement was driven by higher levels of market turnover, we continue to see growing demand for our dark crossing products. Average daily value traded in POSIT was up almost 200%, and POSIT Alert volume more than doubled during the first quarter as compared to the first quarter of 2013. ITG now represents more than 13% of total European dark trading. Our team in Europe has made tremendous progress over the past two years. But we think there is still more ground to be gained in the region.

We also saw improvements in our Canadian results. Our local volumes there increased more than 20% compared to the first quarter of 2013 versus an increase of just 11% in overall market volumes. Our sell-side dark pool Match Now continues to gain momentum. It now represents almost 3% of total Canadian trading volume.

In the Asia Pacific region, our total revenues dipped in the first quarter of 2014, in part reflecting lower overall market volumes. We still believe there are positive long-term trends in our favor, notably a growing appetite for lower cost, lower-impact dark trading, which is why we see POSIT Alert as a big opportunity in Asia Pac in the coming quarters.

We launched POSIT Korea during the first quarter, marking the 32nd global market where POSIT is available. During the quarter, we continued to innovate and bring new products to market. We launched a new hedge fund initiative, rolling out a dedicated order management system designed for hedge funds called ITG Position Manager, as well as a new version of Triton Black, our single stock focused execution management system. Also, during the quarter Triton was recognized by Wall Street Letter as the best equities trading platform.

We also deployed ITG Smart Limit Algorithm, or SLimit, which gives buy-side traders powerful trading technologies so that they can trade passively and capture spread, reducing their overall execution costs. And we launched our first app – mobile app, Liquidity Metrics, which offers a free high-level overview of the powerful transaction cost analysis data contained within the ITG Peer database.

In our ITG Investment Research unit, we initiated coverage on the semiconductor sector, issued pre-IPO research on GrubHub and Dropbox, and made alpha-generating calls on companies like Apple, Groupon and Athabasca Oil. We will continue to focus on product group profitability to improve performance. And as Steve will discuss, we made meaningful strides this quarter in the performance of our global Research, Sales and Trading group.

We continue to expect this focus to yield some incremental cost savings both in 2014 and over the longer term. However, some of these savings may be offset by various investments in new business opportunities, which we are reviewing.

In conclusion, we are pleased with our first quarter results and believe that 2014 is off to a good start. Our focus on global investment, coupled with improved cost efficiencies, has significantly improved our profitability, and we believe that we are in a good position to make further progress.

We expect the balance of 2014 to bring continued debate in many quarters about financial regulation, both in the U.S. and elsewhere. But we are confident in our ability to adapt to evolving equity market structure and to – to continue to serve as a trusted partner to our clients as they navigate through the changes ahead.

With that, I'd like to turn it over to our Chief Financial Officer, Steve Vigliotti, to review the first quarter financial results.

Steven R. Vigliotti

Chief Financial Officer & Managing Director, Investment Technology Group, Inc.

Thanks, Bob, and good morning, everyone. A second straight record quarter for our European region, together with continued cost management, drove a sharp jump in net income during the first quarter, pushing our earnings per share to their highest level in over four years. We also saw meaningful margin improvement from a few of our global product groups, demonstrating that this focus continues to pay off.

As noted on slide eight, we generated consolidated revenues of $137.6 million during the first quarter, approximately 4% higher in both the fourth quarter of 2013 and the first quarter of 2013. We posted GAAP net income of $0.37 per share in the first quarter of 2014. This compares to GAAP net income of $0.26 per share in the fourth quarter of 2013, and GAAP net income of $0.22 per share in the first quarter of 2013.

On slide nine, we have detailed the non-operating items included in our GAAP results for the first quarter of 2013. In the first quarter of 2013, we incurred duplicate rent charges while we built out our new headquarters in lower Manhattan. Excluding this item, adjusted net income for the first quarter of 2013 was $0.24 per share. There were no non-operating items in either the first quarter of 2014 or the fourth quarter of 2013.

For the rest of this discussion, all references to results and costs for the first quarter of 2013 will be on an adjusted basis. Slide 10 presents our consolidated results, along with separate breakdowns of the results from our U.S. and international operations. On a year-over-year comparative basis, consolidated expenses were down $600,000, even with the incremental variable costs associated with a $5.5 million increase in revenues.

Our consolidated pre-tax margin was 13.4%, up from both 8.1% in the fourth quarter of 2013, and 9.3% in the first quarter of 2013. Our consolidated effective tax rate was 26.1% for the quarter, reflecting the high mix of earnings from our international operations, particularly Europe.

During the first quarter of 2014, we posted net income of $0.07 per share in the U.S. on revenues of $75.6 million, up from $0.01 per share in the fourth quarter of 2013. This improvement was driven by a 5% reduction in expenses, as revenues were essentially flat on a sequential quarter basis. Earnings were down from $0.14 per share in the first quarter of 2013 due to lower volume levels.

Our first quarter pre-tax margin in the U.S. was 6.4%, up from the fourth quarter of 2013, but down from the first quarter of 2013. As a reminder, the U.S. segment bears nearly all of the firm's corporate costs, which negatively impacts pre-tax margins reported for that segment. These costs, which totaled approximately $5.5 million per quarter, include among others the cost of being a public company, intangible amortization, interest expense, and the cost of maintaining our global transfer pricing structure.

Excluding these costs, our U.S. pre-tax margin in the first quarter would have been 13.6%. Our combined international businesses posted net income in the first quarter of $0.30 per share on revenues of $62 million. Our international pre-tax margin rate rose to 21.9%.

On slide 11, you can see that our U.S. expenses also declined 5% for the first quarter of 2013, due chiefly to lower transaction processing costs associated with reduced trading activity and with an increase in the amount of passive trading by our clients and lower market data and connectivity costs.

These reductions were offset in part by higher compensation costs, as our compensation ratio increased to 42.9% due in part to improved global profitability. Transaction processing costs, as a percentage of revenue, were down to 11.8% versus 12% in the fourth quarter of 2013 and 14% in the first quarter of 2013.

On slide 12, we provide a summary of our international results. Revenues were up $5.4 million from the fourth quarter of 2013 and up $11.1 million from the first quarter of 2013. Our growth in European revenues from the fourth quarter kept pace with the overall market increase in value traded, while in Canada we posted modest revenue growth compared to both the fourth quarter and the first quarter of 2013 despite a reduction from both periods in the currency translation rate.

Our Asia Pacific revenues were down 14% compared to both the fourth quarter and the first quarter of 2013, due in part to the impact of a $900,000 client trade accommodation loss associated with connectivity issues we had on a day when we were processing large trades.

International expenses were higher in both the fourth quarter and the first quarter of 2013, due largely to the impact of transaction processing costs and variable compensation costs on higher revenue levels. The compensation ratio for our combined international operations fell to 30.2%. This ratio was lower than both the fourth quarter and the first quarter of 2013, due in large part to the impact of higher overall international revenues.

Combined international transaction processing costs during the quarter, as a percentage of revenue, were 18.7%, lower than both the fourth quarter and the first quarter of 2013, due in part to a higher portion of our value traded in Europe crossing POSIT.

On the next slide, we track the performance of our foreign segments over the past five quarters. As compared to both the fourth quarter and the first quarter of 2013, Europe and Canada posted higher revenues and higher pre-tax profitability, while Asia Pacific saw a decline due in part to the client trade accommodation losses.

On slide 14, we offer supplementary information on revenues broken out by our four product groups over the last five quarters. The table also includes a corporate group, which primarily reflects investment income that is not directly attributable to any of the product groups.

As you can see from this table, Electronic Brokerage revenues were up 5%, both year-over-year and sequentially, driven by increased activity in European POSIT and POSIT Alert. The significant growth in European activity from the first quarter of 2013 was offset in part by lower U.S. volumes.

Revenues from Research, Sales and Trading were up 8% sequentially and 15% over the first quarter of 2013 due to increased commissions on high-touch trading in the U.S., Canada and Europe. The growth over the first quarter of 2013 also reflected higher levels of recurring energy research revenues.

Our Platforms group saw a 2% increase in sequential revenues, but a 5% decline versus the first quarter of 2013. The year-over-year decline is due to a decrease in revenues derived from our OMS platform and from a reduction in shared commission revenues in the U.S. from the ITG Electronic Brokerage group due to the lower volumes. These year-over-year declines were partly offset by higher Triton commission share revenues in Europe and by growth in stand-alone network connectivity revenue.

Analytics revenues were essentially flat compared to both the fourth quarter and the first quarter of 2013.

On slide 15, we are presenting supplementary pre-tax information for our four product groups and for our corporate function for the first quarter of 2014, with a comparison to the margin rate for full year 2013.

You will notice that three of the product groups saw increases in margin rates as compared to full year 2013. The sharp drop in revenues described above pushed the margin rate for Research, Sales and Trading to 8.8% compared to 0.8% for the full year 2013. The improvement in the Electronic Brokerage margin rate was also driven primarily by revenue growth. However, the improvement in the Platforms margin rate was largely driven by operating efficiency, as we've been able to rationalize costs in areas such as market data and infrastructure.

On slide 16, we have presented our U.S. volume and rate capture statistics. Our average daily executed volume was up 11% versus the fourth quarter and down 15% versus the first quarter of 2013. Our average overall revenue capture rate rose – excuse me, per share was $0.0047, steady from the fourth quarter of 2013, and up from $0.0046 in the first quarter of 2013.

The percentage of sell-side volume fell to 51% from 53% in the fourth quarter of 2013. We ended the quarter with $222.7 million of cash and cash equivalents on our balance sheet, down from $261.9 million at year-end due primarily to the payment of 2013 incentive compensation and the reduction in short-term bank loans.

Our excess cash on March 31, over and above what we need for regulatory capital, debt payments, and compensation liabilities, was $65 million, slightly higher than the fourth quarter amount. We were a little more opportunistic with our research program – repurchase program during the first quarter than we had been in recent quarters, and we purchased 743,800 shares for $12.7 million or $17.10 per share.

As a reminder, we expect to repurchase at least 200,000 shares per quarter to offset the dilution from issuances of shares under our stock compensation program, with additional repurchases dependent on market conditions. Our buyback program has reduced shares outstanding, net of issuances, by almost 18% over the past four years.

Looking forward, I would like to offer the following observations. Our US average daily volume for April was approximately 153 million shares at an average rate slightly higher than our first quarter average. In our combined international business, our average daily commissions in April were in line with our first quarter average.

And with that, I'd like to open the call to Q&A. Operator, please open up the lines for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] And the first question comes from Chris Allen at Evercore. Please go ahead.

Chris J. Allen
Analyst, Evercore Partners (Securities)

Q

Hey, morning, guys.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Hey, good morning, Chris.

Chris J. Allen
Analyst, Evercore Partners (Securities)

Q

Just to clarify, April was 153 million or 163 million?

Steven R. Vigliotti
Chief Financial Officer & Managing Director, Investment Technology Group, Inc.

A

53 million.

Chris J. Allen
Analyst, Evercore Partners (Securities)

Q

Okay, great. And then just on the – kind of working backwards from your last comments, the capture rate, 51% sell-side this quarter, versus 53% last quarter; an improvement. Would've expected maybe a little bit more of a bump in the capture rate overall. Was there any shift in the buy-side rate card this quarter?

Steven R. Vigliotti
Chief Financial Officer & Managing Director, Investment Technology Group, Inc.

A

Yes, we had a little more flow from passive accounts, who tend to use less of our higher premium products.

Chris J. Allen
Analyst, Evercore Partners (Securities)

Q

Got it. Okay. And then, the expense discipline was great this quarter. Just wondering any – when we're kind of looking at the sequential improvement, in the US business specifically, around occupancy and equipment and other G&A, I mean any color in terms of what drove that and how to think about the run rate moving forward there?

Steven R. Vigliotti
Chief Financial Officer & Managing Director, Investment Technology Group, Inc.

A

Yes. So, Chris, for G&A, I mean that cost – you will see some variability in that cost from time to time. And that one expense does tend to fluctuate a little more depending on the timing of when we use certain services like, for example, consultants for various projects or legal and tax professionals, as well as the timing of various marketing campaigns. So, you might see some variability there.

With regard to occupancy and equipment and telecom and data processing, the improvements there continue to be driven by the focus we put here at ITG on product group profitability. So, we think that is sustainable and there may be some opportunities for further improvement. But having – similar to what Bob said earlier, we may offset some of those savings down the road with some select investments in growth initiatives.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Got it. And then, just on the international businesses, the comp accrual was at 30.2% even with the $900,000 hit in Asia Pac, I mean should we expect further leverage there moving forward, if we kind of expect stable to growing revenues from here? Any color on that?

Steven R. Vigliotti
Chief Financial Officer & Managing Director, Investment Technology Group, Inc.
A

Yes, I think it's similar revenue levels. The rate should be about where it is. If revenues were to take another notch up, you might see a further scaling in the rate, and conversely if there was a dip, you might see the rate pick up a little bit.

Chris J. Allen
Analyst, Evercore Partners (Securities)
Q

Great. I'll get back in the queue. Thank you, guys.

Steven R. Vigliotti
Chief Financial Officer & Managing Director, Investment Technology Group, Inc.
A

Okay.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.
A

Thanks, Chris.

Operator: Your next question comes from Rich Repetto from Sandler O'Neill. Please go ahead.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP
Q

Yes. Good morning, guys.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.
A

Good morning, Rich.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP
Q

Congrats on a very strong quarter. I guess you've mentioned over the past couple calls now this potential investment in new business opportunity. And I was just trying to see the status; does it seem like it's going on pace to what you would expect? Or what is the holdup?

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.
A

Yes. So, one of the things I alluded to in my comments obviously, Rich, was the fact that we are investing in the hedge fund space. We put out a new hedge fund offering, which is in some ways just a productization of all of our capabilities. But it does contain something new, which is this notion of going after the hedge fund OMS business more aggressively than we have in the past. And in fact, our OMS product in hedge funds has been nonexistent. So, we've added that to the mix here.

And it's part of an overall effort to follow hedge funds through their life cycle. So, we are no longer just skating to the puck when somebody gets to $5 billion in assets. We want to be there when they are crossing through $100 million or $200 million in assets. And we want to participate and partner with them in their growth. And that's – that's really in many ways a new business initiative for us. And we are really – in terms of the early returns on that, the benefits for our Electronic Brokerage business, our Platform business and our high-touch Research, Sales and Trading business, I think, are pretty obvious if we get that right, and we are focused on doing exactly that.

In terms of other investments, as you might expect, the market structure in other asset classes is changing, FX and fixed income more specifically. As you also probably would expect, those market structures are starting to look a little bit more like the equity business, although there is – we have a tremendous amount of sobriety about the barriers to entry there and the things we need to do and need to build to compete.

We – I think we're cautious as we always have been to not comment too deeply on them, because we could very easily get out of our skis. The one that we are obviously willing to comment about is FX TCA, which is off to a fantastic start and continues to gain momentum. And it's absolutely right for the times in terms of the scrutiny around FX market structure. They are fixing all those things that are now front and center just as they have been in equities for quite some time. So, more to come on that front, but yes, we are investing organically in those various initiatives.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP
Q

Okay. And I was actually – thank you for that answer. I was actually referring to maybe inorganic, the potential to do acquisitions of certain assets and any progress there.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.
A

Well, I mean, we – as you saw from Steve's prepared remarks, the balance sheet is as strong as it's ever been. We have more firepower in terms of the stock price than we've had in quite some time. We're looking at every opportunity we think makes sense in terms of the combination with our existing business model.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP
Q

Okay. And then I guess the last thing, Bob, would be – you're in touch with the regulators, and you're operating POSIT Alert, which is the block trading platform. That seems like it's sort of removed from the scrutiny here. But in regards to just the dark, the POSIT, can you talk about how it is operating? Do you allow high-frequency traders in there? And what is the pricing based off of?

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.
A

Yes. We don't comment on any client, that's a part of the POSIT dark pool. But I will tell you that this is a momentous occasion, to put out our ATS filing in the public domain. There is only one other firm that's done that, and ours is unredacted. So, there is nothing x-ed out or blackened out in terms of the – in terms of the document. We've also I think – have accompanied that with a plain-English guide to executions in POSIT, which we think will be very, very helpful to everyone understanding exactly how it operates.

So, you're right. I mean, Alert – in POSIT Alert and the fact that we operate in 32 countries, we're trading anywhere from $1.5 billion to $2 billion notional in that facility every day around the globe. It's growing nicely in Asia. We had a record month in April – in Asia Pac for Alert. We're off to a good start there.

This environment screams for products like Alert, right; block anonymous liquidity, in all circumstances. Irregardless of your view of HFT, bad or good or any of the other religious debates that are going on out there, it screams for the value of POSIT to the institutional investor's outcome.

Richard H. Repetto
Analyst, Sandler O'Neill & Partners LP

Q

I agree. Congrats on a strong quarter.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Yes, thanks, Rich.

Operator: Your next question comes from Niamh Alexander from KBW.

Niamh Alexander
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi, good morning. Thanks for taking my questions. Thank you.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Hi.

Niamh Alexander
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hi. Can I start with the – I guess, the high-frequency trading? And thanks for your prepared remarks and for putting out the POSIT filing, ATS. I am not sure all the non-traders are going to work through all the technical terms there; but I think it is a positive start. But some of the things that we think maybe the regulators – who very clearly kind of said earlier this week that they're going to be data-driven in their analysis, and not to make changes just because of the appearance of some things that might be unfair, rather what actually is. But we think some things, like maybe a trade-at rule or starting to limit or impose some thresholds around dark pools, might be some of the pilots that can come back up; but we don't know. But help me think about the trade-at. That's kind of internalization, but you do some riskless principal matching in that sell-side. That wouldn't impact your business; or would it, if that changed?

And then, on the dark pools, how do you think about the risk that your true wholesale dark pools kind of get washed in with some of these potential restrictions that might come out on kind of these faster, lower-share execution dark pools?

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Yes. It's always a risk, Niamh. And don't forget that we are dealing with regulatory change and very fluid regulatory environments around the globe, right. So we've experienced changes in the dark and the trade-at, and minimum price improvements in Canada and Australia already. Our Match Now pool is doing very well in Canada. We expect – Alert is doing the – will do the same in Australia; although, as part of the whole Asia Pac offering, it's had a very, very good month in Aus and the rest of the region.

In Europe, obviously, MiFID II is looming. I am just back from Paris. We had a great client dinner there with regulators and clients; facilitated what I thought was an extraordinary dialogue around dark liquidity, the value of dark liquidity. Clients are very out loud about blocks and about the importance of blocks. There is a large-scale exemption, I think, that will be a big part of the new regs that will benefit us.

In the U.S., we were close – back in 2010, we were close to new dark pool regs that we were, I think, very much on board with. And you started to see the manifestation, at least the first manifestation of that, with the new publicly reported volume rules. But yes, there's probably some more to come, but we think the unique value of what we do within our dark pool that is now out loud in the public domain for everyone to see, we think is – it remains extraordinarily valuable and unique relative to our competitors.

Niamh Alexander
Analyst, Keefe, Bruyette & Woods, Inc.

Q

So, there could be some grandfathering or something like that for the bigger wholesale ones. And then on the trade-at, if that came into effect or you going to pilot on something like that, that wouldn't impact your riskless principal business, would it?

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

It's hard to say, I mean, in terms of minimum price improvement, what form that would take. But we game theory all of this stuff and – as we have in Europe. I mean, I think – as I said, the global experience gives us, I think, a good background, good grounding, in how to deal with change. And certainly, we feel very good about our product offering and the flexibility it provides us in terms of responding to that change.

Niamh Alexander
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Fair enough. I guess [indiscernible] (31:19) is a good study. And then if I could, Steve, on the finances – and I apologize if I missed this earlier. But the compensation ratio in the international business was really, really low. I mean, is there anything to make me think that this isn't the run rate? Is there something unusual in there?

Steven R. Vigliotti
Chief Financial Officer & Managing Director, Investment Technology Group, Inc.

A

No, there really isn't anything unusual in there. One thing to keep in mind, which took effect this quarter was – remember, back in the second quarter of last year, we announced a restructuring where we were going to migrate our Israeli development center from a wholly-owned subsidiary to an outsourced solution. So, what was previously employees with compensation showing up in our international comp rate is now showing up as G&A. So, there's a little bit of time, but most of the improvement in the rate maybe was just the impact of higher revenues and our ability to scale a little bit with the higher revenues. So as I mentioned, I think, in response to

Chris' question, I think you could see that scale a little more if revenues were to grow or maybe pull back a little bit if revenues were to come down over the coming quarters.

Niamh Alexander
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, fair enough. And then, just one more if I could, just back to the US. I mean, it's a smaller part of the earnings now; but the volume decline so far into the quarter – it's still early – but sequentially it's kind of – it's down double digit, whereas we are looking at industrywide down maybe 4%, 5%. And the trend of investor allocation into more active funds and some of these passive funds, that should be favoring ITG. What do you think is going on there that it looks like you're kind of losing some market share?

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Yes, I – well, I don't know that we are losing market share, but I would say that – I would say that it's – certainly that the environment is a little different than the ones we've encountered before. Clearly, the IPO calendar was very powerful in Q1 and certainly there is a lot of alignment between IPO calendar and IPO performance and secondary commissions. And so, yes, I think on the margin that probably hurt us a little bit, but the U.S. is still - it's a very big part of the international business as well, right? So, while we may have – while in the U.S. we may have – the revs and the volumes may have dipped a little – not revs, but the volumes may have dipped a little bit, I think the contribution the U.S. continues to make to Europe and to Asia Pac and to Canada for that matter is an important one.

So, yes, I mean it's something we are very focused on. We do – I do – I'm very excited by this new initiative that we started. I would encourage everyone to go to our website and pull down the – what's now the transparency tab. And it really gives us I think an incredible opportunity to reengage, reignite and communicate with clients directly about the things that continue to make us different. So, yes – so we're – certainly we're not sitting here waiting for anything to change. We're aggressively going after U.S. revs and volume every day.

Niamh Alexander
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay, thanks. I'll get back in the line.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Thanks, Niamh.

Operator: [Operator Instructions] And our next question comes from James Ellman from Ascend. Please go ahead.

James Ellman
Portfolio Manager, Ascend Capital LLC

Q

Yes, thank you very much for taking my question. After the infomercial from IEX in Flash Boys, I was hoping you might be able to – just to maybe compare or contrast how your product in POSIT is similar. And do you think that the media attention here might move some market share in your direction?

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Yes. I don't know that we're drawn into Flash Boys or IEX. As I said, I do – I do want to – we do want to talk about ITG and what continues to make us unique. We're doing this for 27 years as a firm. We've been engaged in market structure debates and dialog many, many times before dating back to Reg ATS, Reg NMS. The dark pool concept release back in, as I said, 2009, 2010. We're very actively engaged there as you might expect. MiFID I, MiFID II, certainly that applies globally, all of that.

And we think that dialog and debate is a good thing. We think that the light of day is a good thing. So, the one thing that is – that we think is very positive coming out of this is that you've got a situation where people care more deeply about market structure and about how brokers are executing on their behalf. We think the IEX guys have done a fantastic job of highlighting all of that.

So, from our perspective, we respect them as an innovator, as being disruptive in the space. We do believe that ITG and, more specifically, POSIT as part of U.S. market structure remains very unique as well.

James Ellman
Portfolio Manager, Ascend Capital LLC

Q

Okay. But is your primary product in the U.S. equity market a similar offering in terms of transparency, latency, et cetera, versus IEX, just with a larger share and larger volume?

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Yes. It's different in that it is institutional primarily and it does have, as I said, the block capabilities and the block exposure. That is different. 35,000 shares per trade in Alert is a big number as you are aware relative to the exchanges in the other multi-lateral dark pools. So, I think that's...

James Ellman
Portfolio Manager, Ascend Capital LLC

Q

One other – okay.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

That's what continues to distinguish POSIT.

James Ellman
Portfolio Manager, Ascend Capital LLC

Q

Thank you. One other quick question would just be...

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Sure.

James Ellman
Portfolio Manager, Ascend Capital LLC

Q

...just from this debate, do you believe that it will move market share potentially towards you or away from you? And do you think it changes any M&A outlook in the industry? And does it lead to any other – any dark pools, maybe some sponsored by Goldman Sachs, et cetera, going away and leading to more share for you?

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Yes. Certainly, I don't want to prognosticate about other dark pools and their capabilities or their business models. But I would say that I – we are obviously optimistic and we think today's disclosure of the POSIT ATS filing and all the other things we are going to provide, which we've been doing for quite some time, will create opportunities for us – renewed opportunities for us to tell our story and to differentiate the firm.

James Ellman
Portfolio Manager, Ascend Capital LLC

Q

Very good. Thanks so much.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

A

Thank you.

Operator: This concludes our question-and-answer session. I would now like to turn the conference back over to Mr. Bob Gasser. Please go ahead.

Bob C. Gasser
President, Chief Executive Officer & Director, Investment Technology Group, Inc.

We very much appreciate you joining us today. And we look forward to speaking to you on the second quarter call out in end July – end of July. Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.