FINAL TRANSCRIPT

Thomson StreetEvents℠

ITG - Q4 2010 Investment Technology Group Earnings Conference Call

Event Date/Time: Feb. 03. 2011 / 4:00PM GMT

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PRESENTATION

Operator

Good morning, and thank you for joining us to discuss the Investment Technology Group's fourth quarter results for 2010. My name is Eric, and I will facilitate the call today. After the speakers' remarks, there will be a question and answer period.

(Operator Instructions).

I would now like to turn the call over to J.T. Farley, ITG. Please proceed.

J.T. Farley - *Investment Technology Group - VP of Investor Relations*

Thank you, Eric, and good morning. In accordance with the Safe Harbor Regulations, I would like to advise you that any 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. Reconciliation of these non-GAAP measures to the comparable GAAP measures can be found in this morning's press release. The release and the PowerPoint slides which accompany this presentation are available for download on the investor relations section of www. itg.com. We have with us this morning our CEO, Bob Gasser, and our CFO, Steve Vigliotti. To begin, we will turn it over to Bob.

Bob Gasser - *Investment Technology Group - CEO and President*

Thanks, J.T. Good morning to you and thank you for joining us to discuss ITG's fourth quarter. This morning, I will cover three main points. First, the most recent data on industry conditions, how they impacted Q4 performance and what they imply for 2011. Second, an update on our competitive strategy with particular emphasis on ITG Research, and third, our capital allocation priorities including the role of the new line of credit that we announced this morning. First I will start out with industry conditions.

Let's start by looking at the most recent industry trends. As you know there has been a long string of net outflows from domestic mutual funds. From the beginning of May to the end of December, 34 of the 35 weeks showed net outflows. The cumulative outflow from domestic funds over this period was nearly $95 billion, although there was some offset from $28 billion flowing into international funds.

In the New Year, we are beginning to see what is hopefully a positive trend towards net inflows into domestic equities. The constant din we've been hearing about the relative performance of fixed income, relative to equity seems to be turning in the New Year. Concerned about municipal defaults, the steepening yield curve, US debt ratings, and tough comparisons in a new calendar year give us some optimism that the relative value trade may finally be reversing itself.

Whether or not January marks a break in trend, it is clear that 2010 was marked by a period of atypical investor behavior. History shows that investors begin putting the money back into mutual funds within one quarter of the equity markets turning back up. The reluctance to do that throughout the current market rally is a reflection of how traumatic the financial crisis has been, as well as how the flash crash last May exacerbated the already high levels of investor risk aversion, particularly towards US equities.

As far as the outlook for 2011, the best we can say is that it remains highly uncertain. While the generally lower levels for the VIX indicate that professional investors are less risk-averse, there is no clear evidence yet that the prolonged market rally and signs of general economic improvements are having a lasting effect on individual investors' willingness to return to equity mutual funds. I was particularly encouraged, however, by the BlackRock earnings call commentary and their observation that institutions are re-risking, to use their term.

What's been impact on ITG performance? The impact on Q4 industry conditions is evident, with cash equity volumes in the US down more than 9% year-over-year.

In terms of our fourth quarter volumes, ITG continued to perform well versus the competition, with volumes down just 2% over the prior-year period. In the US, POSIT average daily volume during the fourth quarter surged to 76 million shares, compared to 62 million shares in Q3. The average block size in POSIT alert in Q4 was about 36,000 shares, down only slightly from the third quarter.

While volumes outperformed, our revenue per share saw further declines. Due to the continued weakness in traditional long-only volumes, we saw a further shift in our mix to lower rate trading, including growth in our sell-side business. We also had a lot of year-end portfolio rebalancing, which is usually done at lower commission rates. The revenue capture per share on net executions was also under pressure, as bid/ask spreads on S&P 500 stocks narrowed 8.0% versus the third quarter, due to continued bottoming and volatility.

Excluding the impacts of the mix shift, the rebalance trades, and the net execution business, our underlying rate par was actually pretty stable in the fourth quarter, and we are seeing clients who are paying for ITG Investment Research commented a higher rate card in Q1 2011.

Looking to our international operations, we saw strong growth all around during the fourth quarter. In Canada, we saw revenues increase by 22% over Q3. POSIT is gaining traction in the market, and our broker-neutral dark pool, MATCH Now, had another record quarter, our stronger quarter. Our strong institutional relationships coupled with technology improvements to reduce latency are clearly paying off.

Europe also saw revenue growth, up by 9% versus Q3, while pan-European turnover during the quarter was up only 5%. POSIT gained traction, with POSIT Now, POSIT Alert, and ITG's algorithms all improving their crossing rates. European portfolio trading also saw considerable improvement with renewed flow from US-based asset managers.

Asia-Pacific posted record revenues of $9.4 million, and narrowed the operating loss by 45%, compared to the third quarter. POSIT Marketplace launched in Australia during the quarter and continues to pick up steam in Hong Kong. Our TCA research shows that Hong Kong ranks among the highest trading cost of developed equity markets, and with POSIT Marketplace, our clients are saving an average of 10 basis points on every trade. David Stevens is making steady progress in his efforts to reorganize and re-energize that region's business.

Against this background, ITG continues to operate as if the lower level of equity investment and related trading activity is the new normal. We continue to reduce operating costs to reflect the lower levels of revenue. We are diversifying our client touch points to bring in additional sources of revenue through continued strategic investments. It's all about creating multiple opportunities and obligations for the client to trade with ITG.

Reflecting ITG's strong competitive position, Waters Technology recently named Triton the Best Execution Management System in its 2010 Buy-side Technology Awards. Financial News named Triton the Best Buy-side Trading System as part of their 2010 Excellence in Trading and Technology Awards. And Asian Investor named ITG as Best Provider of Trading Technology Solutions. In the most recent TABB Group reports on institutional equities, ITG was named as number two among all brokers receiving the most commissions for providing algorithms, and number two as the best provider of algorithms for less liquid names. In both cases, we were the top independent firm in the category. And, importantly, the TABB report recognized ITG as the number one dark pool in the industry, beating out all of the buldge bracket, as well as Liquidnet.

Overall, our competitive position is strong, and we continue to enhance it with product, service, and technology innovations. During Q4, we acquired the Clearvoyance Settlement Aggregation Software System from ESP Technologies. We are integrating Clearvoyance with our ITG Single Ticket Clearing system, which makes ITG the leading trade aggregation offering. This is a good example of a bolt-on deal which enables us to provide expertise and services across the trading continuum, while deepening our strategic client relationships. This deal will be immediately accretive and has already provided us with synergistic opportunities in our CSA and execution businesses. We have converted the vast majority of ESP clients to our global clearing platforms, and re-invigorated the ESP pipeline.

The most important strategic expansion and diversification of our offering is undoubtedly ITG Investment Research, or ITG IR, as it is known internally. With the recent acquisition of Majestic, we have established a significant platform for transforming our business model. Our intent is to make our independent research offering a significant factor in driving commission allocations to ITG. We believe the combination of independent, data-driven, alpha-generating research, with our agency brokerage approach, provides a compelling value proposition to clients. We look to expand the research platform in terms of both sectors in geography over the course of 2011.

We are on track in integrating ITG IR into our business. We had about 120 clients in common at the time of the acquisition, while 80 formerly Majestic clients are new relationships for ITG. With those 80 clients, our focus has been on converting them from paying their research obligations via third-party CSAs or hard dollars to allocating trading volume to ITG instead. As you may remember, Majestic was only paid on a subscription basis in their previous model, providing a key synergy opportunity for our two businesses. The progress here has been substantial. Already, a number of these clients have begun to trade with us, and over the course of the next few weeks, we expect to have more than 25 of these accounts satisfying their research obligations by trading with ITG, with more to come throughout the year. This transition will begin to show up in our Q1 volumes and rate card, and should continue throughout 2011. It's important to note that because most clients pay for Majestic in advance, the negotiations we've had with clients about the combined offering have been focused on 2011.

It's also important to point out the differences of the hedge fund and long-only space. Speaking in gross generalizations, the hedge fund client requires a shorter sales cycle versus the long-only research voting processes; as the sell-side analysts on this call are probably painful aware. It's easy to see why the Street is drawn like bees to the hedge fund honey. We are investing in research sales, funded by cost savings in other parts of the business to maximize the return from the ITG IR product.

ITG IR greatly increases our traction with hedge funds. Approximately 75% of Majestic's legacy business was with hedge funds. Adding independent research to our mix has really gotten their attention, and the foot in the door provided by the research can broaden our overall relationships into things like CSAs and derivatives execution. In the few short months we have had the research product we have seen alpha-generating research calls which have outperformed the Street consensus, in names like Apple, Best Buy, Netflix, and CoinStar.

The data-driven objective methodology behind our research is a key differentiator. By relying largely upon analysis of both proprietary and publicly available data sets, ITG IR does not pose the potential compliance issues which are faced by so-called expert network firms. These issues mean there are fewer alternatives for investors looking for differentiated content to add to their research mosaic.

In fact, the buy-side's increasing reluctance to use expert networks could provide an opportunity for ITG IR. Integrity Research Associates estimate that expert network firms generate $400 million in revenues last year. As the buy-side looks to reallocate some of that spending, we intend to compete aggressively for that jump off. In short, it's still very early days for our content strategy, but our experience so far makes us confident we are on the right track.

Let's turn now to capital allocation and cost discipline. 2010 was a year in which ITG reallocated about $150 million of cash. The allocation was pretty evenly spread across three priorities. $47 million went to pay off the remainder of our long-term debt, $53 million to make an important strategic acquisition, and $50 million to buy back shares. Going forward, we intend to continue to return capital to shareholders, while, at the same time, seeking strategic acquisitions which enhance our capabilities across our platform. We also announced this morning that we have entered into a three-year, $150 million line of credit. The purpose of this credit line is to fund liquidity for our broker dealer operations, primarily to cover its settlement obligations. Steve will provide more details on this line shortly.

In terms of cost, the restructuring plan that we enacted in the fourth quarter of 2009 and the ongoing efforts to manage expenses yielded savings in the US during 2010 of more than $30 million in non-transaction costs, excluding the impact of the Majestic acquisition. We continue to hold the line on expenses and find new sources a reduction like the closure of our Rye Brook office.

As of the end of fourth quarter our full-time global headcount was 1,186 employees. That is up from 1,140 at the end of the third quarter, but it also includes more than 80 new employees, due to the ITG Investment Research and Clearvoyance acquisitions. Despite the managed attrition we had during the year, we built quite a bit of bench strength across our firm in 2010.

So to sum up, the money management business is operating through tough and uncertain times as we enter 2011, which means the same applies to the trading and research business. At ITG, we continue to invest in products, services, and technology that enhance our competitive position. And, through ITG Investment Research, we've embarked on a strategy that positions us well to penetrate existing accounts further, win new clients, and improve overall stickiness. We have a strong but more efficient balance sheet going into 2011. Our ability to continue generating strong cash flow gives us the flexibility to make acquisitions that support our stated goal of creating more obligations and opportunities for clients to trade. The cash flow also allows us to continue repatriating capital through our stock repurchase program.

Finally, I'd like to thank my colleagues around the world for their efforts on the firm's behalf. They have shouldered the responsibility of executing throughout the last two years. While we look back on 2009 as a turning point for global institutional equity trading volumes, 2010 was materially worse from an environmental perspective. Throughout this tough period, ITG has maintained its product leadership and reputation for first class service and support, thanks to them.

With that background, I would like to turn to our CFO, Steve Vigliotti, to take you through the Q4 financial highlights.

Steve Vigliotti - *Investment Technology Group - CFO*

Thanks, Bob. During the fourth quarter, we saw strong performance from our international operations, as reflected by 15% sequential growth in international revenues, and a $3.4 million sequential improvement on international adjusted net income. This improvement was, however, more than offset by the challenges faced by our US business, most notably the continuation of reduced trading activity by active fund managers and the impact that has had on our mix of business. As noted on slide eight, we generated revenues of $138.3 million during the fourth quarter, 8.0% lower than the fourth quarter of 2009, reflecting the challenging market conditions for equity trading. The reduction in revenue from the fourth quarter of 2009 was attributable in part to a reduced revenue capture rate per share on our US volume, which I will discuss in a few moments. Net income for the quarter on a GAAP basis was $0.04 per share, compared to a GAAP net loss of $0.18 per share in the fourth quarter of 2009, with both amounts inclusive of non-operating items.

On slide nine, we have detailed the non-operating items included in our GAAP results for the fourth quarter of 2010, and the fourth quarter of 2009. In the fourth quarter 2010, we incurred charges related to the Majestic acquisition, and the closing of our Westchester office. We've also recorded a gain of $400,000 in restructuring charges related to historical FX translation gains that we reclassified out of equity and into operations following the substantial liquidation of our Japanese subsidiary. As you may recall, we recorded a restructuring charge in the second quarter of this year, when we made the decision to close down these operations. The Majestic acquisition costs included $800,000 of non-cash stock compensation associated with historical Majestic equity awards which were accelerated. $900,000 of professional and other fees, which was slightly higher than we previously estimated, and an additional item of $700,000 for employee separation costs. In the fourth quarter of 2009, we incurred $25.4 million of cost associated with a restructuring plan that was focused largely on the US business. There were no non-operating charges in the third quarter of 2010. Excluding the charges noted above, adjusted net income for the fourth quarter was $0.11 per share, and net income for the fourth quarter of 2009 was $0.19 per share. For the remainder of the discussion, all references to results and costs will be on an adjusted basis, excluding these items.

On slide ten, we have broken down our adjusted results between our US and international operations. During the fourth quarter of 2010, we generated earnings of $0.05 per share in the US, on revenues of $89.5 million. The fourth quarter 2010 US revenues included $5 million of recurring research revenues from the Majestic acquisition, which closed at the end of October. Our combined international businesses generated net income of $0.06 per share, on revenues of $48.8 million. Our consolidated pretax margin was 5.3% for the quarter, compared to 10.9% during the fourth quarter of 2009. Our adjusted effective tax rate for the fourth quarter was 35.8%, compared to 47.8% in the fourth quarter of 2009.

Moving to slide 11, adjusted US expenses were $87.4 million, compared to $89.6 million in the fourth quarter of 2009, and $78 million in the third quarter of 2010. Expenses in the US during the fourth quarter from our newly acquired research business totaled $4.8 million, including $640,000 of stock-based compensation awards associated with retention and performance awards we granted to the management team, as well as $175,000 for amortizing intangibles we recorded as part of purchase price allocations. Fourth quarter US expenses also included $630,000 for employee separation costs unrelated to the Majestic acquisition or Westchester office closing, as well as $2 million of G&A expenses related to a reserve for historical general tax contingencies. Our US compensation expense ratio increased to 42.7%, compared to 39% in the fourth quarter of 2009, and 37% in the third quarter. Excluding the impact of our new research business and the severance charges, the US compensation ratio would have been 40.6% for the fourth quarter. As noted in prior guidance, in periods of declining revenues, our compensation ratio increases as we need to retain our high-caliber workforce in order to remain competitive. Transaction processing costs were $12 million during the fourth quarter, representing 13.4% of revenues, compared to 11.8% during the fourth quarter of

2009, and 12.4% during the third quarter. The reduction in our revenue capture rate per share was a key driver behind this increased ratio.

On slide 12, we have provided a summary of our international results. As compared to the third quarter of 2010, revenues were up $6.5 million inclusive of a positive impact of foreign currency translations of $1.2 million. This improvement reflected the growth of our client business in Canada, continued momentum for us in the Asia-Pacific region, where we had a record quarter of revenues at $9.4 million, and better market conditions in Europe. The compensation ratio for our combined international operations was 38.8%, compared to 42.6% in the third quarter, due in part to improved revenues. Excluding $1.1 million of severance costs during the fourth quarter, our international compensation ratio was 36.6%. Combined international transaction processing costs during the quarter, as a percentage of revenue, were 20%, unchanged from the third quarter.

On the next slide, we track the performance of our foreign segments over the past five quarters. As compared to the third quarter, our pre-tax profit margins were up for all three of our foreign segments. In Asia-Pacific, we reduced our pre-tax loss by 45% sequentially, due to the record revenues I mentioned earlier, as well as continued cost reductions.

On slide 14, we have presented our US volume and rate capture statistics. Our total average daily executed volume was up 6% in the fourth quarter, as compared to the third quarter, while the combined average daily market volume of NYSE and NASDAQ listed securities was down 1.0%. The reduced market activity did, however, contribute to an 8.0% reduction to our revenue capture per share to 53.6 mils as there was a further shift in the mix of our business to higher turnover, lower-rate clients. Other factors that reduced our revenue per share included a significant amount of index rebalancing at low DMA rates and tighter bid-ask spreads on our net executions.

Even during this challenging period, we continue to distribute cash to shareholders in the form of share repurchases. We repurchased 737,000 shares during the quarter at an average price of $15.48, bringing year-to-date repurchases to 3.2 million shares. The total amount spent on share repurchases this year was $50.3 million, representing 132% of our adjusted operating earnings. That is a significantly higher percentage returned to shareholders than most of our peers. We currently have 2.9 million shares available for repurchase under approved authorizations.

We ended the quarter with $317 million of cash and cash equivalence on our balance sheet, down from $339.5 million at September 30, primarily due to the $53 million cash portion of the Majestic acquisition. We also made the final $11.2 million installment on our long-term debt during the quarter, retiring the last portion of that debt.

We are pleased to report the securing of a $150 million, three-year revolving credit facility for our US Brokerage Clearing Operations. This facility will provide additional liquidity for us to meet spikes in clearing margin requirements and to finance temporary claim positions from delivery failures, and nonstandard settlements. We believe this is an important financial backstop for us as we may see increases to our clearing margin in the future due to the expansion of our single ticket clearing business and potential amendments to margin requirements. We also experience higher requirements during period of heightened volatility, such as the $300 million requirement we had in the Fall of 2008. In essence, the credit facility provides us with additional flexibility with the cash on our balance sheet and the cash flow we generate from operations to invest in our business and increase shareholder value through share repurchases.

As Bob mentioned, the integration of our new research business with our sales and trading operation is going well. Based on conversations we have had to date with research clients to pay for their research services through an ITG soft dollar arrangement or a combined ITG commission offering, we remain confident with the 2011 accretion figures we previously provided of $0.05 to $0.10 per share.

Looking ahead to the early part of 2011, we got off to a good start in January with average daily volumes traded in the US of approximately 210 million shares a day, with modest improvement in the average rate per share as compared to the fourth quarter. And, with that, I'd like to open the call to Q&A. Operator, please, open up the lines for questions.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions) Your first question comes from the line of Rich Repetto with Sandler O'Neill. Please proceed.

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

Hi Bob, and Steve. I guess the first question is, you are still comfortable with the Majestic $0.05 to $0.10, and we think that implies around $33 million. You had a $5 million run rate, or at least that is what I thought you said, revenues in 4Q for Majestic. So you still think you'll (inaudible) that up by, whatever it is.

Steve Vigliotti - *Investment Technology Group - CFO*

That was for two months, the $5 million.

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

Okay, so the run rate than would be $7.5 million for Majestic? Is that fair to say right now?

Steve Vigliotti - *Investment Technology Group - CFO*

That was the fourth quarter run rate.

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

Right. Right. Is there anything different about 4Q? Would that be a good run rate? To at least say where the baseline is for Majestic?

Bob Gasser - *Investment Technology Group - CEO and President*

But yeah, I think that is certainly a good baseline. As I said in my remarks, we were very pleased with the integration, very pleased with the customer reception, and very pleased with the penetration of the 80 accounts, and overall I think it is absolutely going according to plan. So, not only do we see the baseline, but we see other upselling opportunities that we're capitalizing on every day.

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

Okay. And then, I guess moving on. Next question. With the new revolver, how should we think about how much cash -- does this mean, you know, you get $300 [million] plus on the balance sheet that, you know, all cash flow generated could be put to capital returns to investors? Or how do you guys think about it?

Steve Vigliotti - *Investment Technology Group - CFO*

Certainly this cash line provides additional flexibility with the cash that we have on the balance sheet to do things like an additional investment or share repurchases. So by having this in place, it frees up up to $50 million of cash that, should we desire to take out of our broker dealer subsidiary, we would still be comfortable with liquidity there knowing we have this line. So that extra cushion, we think, it can make us comfortable that we can continue to repatriate operating earnings through share repurchases.

Bob Gasser - *Investment Technology Group - CEO and President*

And then add it to the lack of debt amortization we now have in 2011, we have what we consider to be extraordinary flexibility in terms of repatriating capital to shareholders, and doing what we have been doing throughout 2010, which is identifying potential strategic opportunities and acting on them.

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

So, you went through the numbers on how much you paid out or bought back through a percentage of net income. Would we expect to see 100% or around that ratio again? I guess is the question? Absent acquisitions?

Steve Vigliotti - *Investment Technology Group - CFO*

I think we will be opportunistic certainly. As acquisition opportunities present themselves, we may have to reconsider what we're doing with our cash. But we don't feel the need to retain extra cash on the balance sheet at this point.

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

Okay. And I guess my last question, Bob, comes from, you know, it does look like the flows are turning a little bit. But still on this quarter, you put up $0.11 compared to much higher earnings in the previous -- maybe not 3Q, but certainly the first half of the year. I am just trying to see. I have not been able, obviously, the comp expense went up, and heavily in the US, US revenues were flat, but I'm just trying to see the run rate here. Where do you expect to see the big jump in the run rate going forward when we are seeing $0.11 or $0.14 here?

Bob Gasser - *Investment Technology Group - CEO and President*

I think it stands to reason that when you have two years of significant and consistent outflows as we have, you are now dealing with a lower asset base and intuitively lower turnover. I think December was an absolute trough in terms of institutional activity. I mean, yeah, our top line average executed volume number looks fine and steady, but that is only because we've replaced what has been a deteriorating institutional business with our net trading business and our sell-side business.

So, when we talk about mixed now, it is not about DMA versus algos versus matching, it is about institutional sell-side and retail flow, and how we're internalizing that and capturing revenue from it. So, with volatility continuing to go down and institutional volumes going down, I think that volume number may be masked a little bit of a mix in December, which I think as most of you guys were aware, I'm sure you felt it yourselves, was an extraordinarily quiet time. Around, I would say, the last three weeks of December were materially worse than the previous nine weeks of the quarter.

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

Got it, okay. That's helpful. So you really need to see improvement in real flows?

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Bob Gasser - *Investment Technology Group - CEO and President*

Yeah, real institutional volumes, and I think that not only that, the thing that gives us some optimism, particularly with having the Majestic acquisition, our Majestic asset, our now ITG investment Research, our marketing people are going to kill me here, but our ITG Investment Research product gives us a lot more confidence in our ability to kick that rate card back up.

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

Okay. Okay. Thank you very much.

Bob Gasser - *Investment Technology Group - CEO and President*

Thank you, Rich.

Operator

Your next question comes from the line of Nick Setyan with Wedbush Securities. Please proceed.

Nick Setyan - *Wedbush Securities - Analyst*

Hi guys, thanks. You just touched upon the rate card, and how it can't possibly be helped by (inaudible) research, and now we're kind of seeing the domestic fund inflows in January. So understanding the negative mix shift impact on the rate card in the December quarter, is it reasonable to expect some stabilization, and maybe even an uptick in Q1 and going forward in the rate card?

Bob Gasser - *Investment Technology Group - CEO and President*

Well, we are hopeful that January is a leading indicator in that we traded, as Steve alluded, approximately 210 million shares a day. We had, I would say a nice bump in the rate card back to something that approximates earlier parts of the year. And that, to me, is a good, hopefully, leading indication. I guess $10 billion of net inflows -- $3 billion, I am sorry. $3 billion in the last week would seem to indicate that we have a little bit of momentum there, clearly building off of a real trough in institutional equity assets in the US. But it's early, and certainly the last thing in the world we want to do after what we've been through in the last couple years is extrapolate that out throughout the course of 2011.

Nick Setyan - *Wedbush Securities - Analyst*

All right, but just to be clear, January you did see a little bit of a bump up?

Bob Gasser - *Investment Technology Group - CEO and President*

Yes, we did.

Nick Setyan - *Wedbush Securities - Analyst*

And then the comp expense in 2011, just on an annual basis. Is it reasonable to model or expect the high 30% range again? Mid-to high 30%?

Steve Vigliotti - *Investment Technology Group - CFO*

I think in the US that is a reasonable rate. Yes.

Nick Setyan - *Wedbush Securities - Analyst*

Okay. Great. Thanks so much.

Bob Gasser - *Investment Technology Group - CEO and President*

Thank you.

Operator

Your next question comes from the line of Ken Worthington with J.P. Morgan. Please proceed.

Ken Worthington - *JPMorgan Chase & Co. - Analyst*

Hi, Good morning.

Bob Gasser - *Investment Technology Group - CEO and President*

Hey, good morning, Ken.

Ken Worthington - *JPMorgan Chase & Co. - Analyst*

On Majestic, I think December 31 was a big renewal period for many of Majestic's clients. How were renewals? Did most the clients renew? Where there any losses that would be unusual? How is that transition?

Bob Gasser - *Investment Technology Group - CEO and President*

The vast majority, I mean the vast, vast majority renewed. They had churn, I think, that's pretty consistent with what they have had in the past. I think a lot of that churn came from the hedge fund turnover. Clearly there are some hedge funds that are not around or clearly have been reduced in size and do not have the capability to pay for it. I think in Q1 already we have been replacing those firms that churned out, and the nice thing about it is we are replacing them with larger firms that are more consistent with ITG's overall institutional profile. So, the answer to your question is yes, they renewed in a very significant way, and the churn was consistent with Majestic's experience in the past, and I think the vast majority of that churn was generated by a loss of assets among a small number of hedge fund clients.

Ken Worthington - *JPMorgan Chase & Co. - Analyst*

And when they renew, is there kind of like, every year when they renew, is there an automatic price increase built in? Or maybe it even changes customer by customer?

Bob Gasser - *Investment Technology Group - CEO and President*

I wouldn't say there is a price increase. I would say there is typically a lot of upselling going on. So the guys who renew intuitively, as you might expect, they're obviously happy with the product. So the question becomes, what else can we sell you at that stage of the game? So it becomes an upselling game as opposed to a price increase game.

Ken Worthington - *JPMorgan Chase & Co. - Analyst*

Okay. And of the 80 clients who are new to ITG, you said 25 will be trading with ITG sometime soon. Are the rest kind of locked into their existing contracts for the rest of the year? Or is there a chance for that 25 to kind of grow over the year as well?

Bob Gasser - *Investment Technology Group - CEO and President*

There's no question that our goal and the possibility of converting those other 55 clients, in our mind, is very high. It may be just because they have a CSA arrangement in place. In all cases, I think just about in every case, it's not because we are getting bundled, and because someone is saying you know, we are not going to pay you, it's because they may want to keep a CSA relationship in place et cetera, et cetera. Obviously, our goal is to bang away -- it means that Majestic's not going to get paid, or IR's not going to be paid, it means that we just haven't created yet the execution leverage that we're looking for.

What has impressed me so far is, and we said this when we did the deal, was that there were some very high-profile names on a client list that we did not transact with. And given our experience so far, it's interesting. I think we have a lot of margin for error. In other words, we can get it right with several handfuls of those guys and meet our plan as Steve articulated. This is the opportunity we thought it would be.

Ken Worthington - *JPMorgan Chase & Co. - Analyst*

Okay. And then of the risk to Majestic was, where ITG and Majestic were both big -- had a big presence with the customers, you get bundled and they basically trade with you and request Majestic for free. To what extent have you succumbed, or even limited areas to that kind of situation?

Bob Gasser - *Investment Technology Group - CEO and President*

You are right, bundling has both a positive and a negative connotation. That is the negative connotation, that we have a large client with a large global relationship and they look at this -- they look at the Majestic or IR pieces being relatively insignificant, and I've got to say, we are ahead of plan in terms of what we thought would happen in terms of bundling. I think the reason we are is because we may have overestimated the degree to which those clients are bundling themselves. In other words, they look at it as two separate businesses, and they are willing to pay for one over here and one over there so they have fully unbundled the research versus the execution piece of the commission dollar.

Ken Worthington - *JPMorgan Chase & Co. - Analyst*

Great. Thank you very much.

Bob Gasser - *Investment Technology Group - CEO and President*

Thank you.

Operator

The next question comes with a light of Niamh Alexander with K.B.W. Please proceed.

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

Hi, thanks for taking my questions. Can I come back to the compensation piece. Can I just understand, there was some -- you're not classifying them as non-recurring, but they don't seem to be expenses we should expect again. So, your comp ratio effective for the quarter excluding those was about over 40s? I am just trying to get back to the mid 30s, I guess, that you've just guided to for the year. Is that kind of based on revenue growth, then? Or am I missing something?

Steve Vigliotti - *Investment Technology Group - CFO*

Yeah, I mean we are at the -- I think we are at mid- to slightly upper- 30s for the entire year, so we think on an annual basis obviously Q4 was a lower period. The ratio does come under pressure when revenues do dip down like that. So though we can't fluctuate it, it's not exactly linear. So, assuming we have some level of balance off the Q4 vine and revenue numbers, we expect that ratio to get more aligned.

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

Still more in line it's kind of the upper- 30s, and if revenue does not grow from here, if we take a turn for the worst, then we should go back to the 40s, right?

Steve Vigliotti - *Investment Technology Group - CFO*

That would be fair to say, yes.

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

Okay, fair enough. Thanks. And then, international did so well this quarter, congrats. Especially Canada, really rocked the head. And then Asia, we saw as you commented on your call, the loss came down quite a lot. Is, kind of, turning profitable within your sights? Because the potential for dropping that tax rate does really have a nice positive impact there.

Bob Gasser - *Investment Technology Group - CEO and President*

Yeah, I think we, Niamh, as you know, we really worked hard in Asia to rationalize that cost structure. The closing of Japan, while painful, was something that was obviously necessary given the size, scope, and strategy for business there. So, I think we are starting to see the benefits of that in addition to the fact that, like I said in my prepared remarks, that Dave is doing a very nice job in terms of the organizational structure and re-energizing the business, but headcount, you know, our geographic footprint, all those things were reduced heavily. And I think what we are seeing now is better efficiency, in terms of not only capital, but resources we have allocated for the region.

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

So is profitability, in that particular area, is that a realistic goal for this year?

Bob Gasser - *Investment Technology Group - CEO and President*

Clearly that is always our goal. It's -- Stay tuned. I think, as we said, the momentum there and the sequential improvement is something that we feel good about.

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

Okay. Thank you. And then lastly, if I could, with the debt announcement, congratulations. I just wanted to understand. I thought, with that, we would get maybe, a bit of a more aggressive share repurchase agenda. But you mentioned acquisitions quite a few times on the call. Can you help me understand where you're looking to next to expand? Because I thought Majestic was kind of the transformative getting you into the Research bucket there.

Bob Gasser - *Investment Technology Group - CEO and President*

It is. There is no question about it. And as I've said repeatedly, there is clearly more [entry] verticals where you can apply the ITG Investment Research methodology. There are more geographies. We certainly have, in our plans for 2011, a goal to expand beyond the shores of the US, and those are all good things.

We are also looking at other big S&P industry groups where, you know, there may be other opportunities for us to bolt on other capabilities, and take advantage of what is now not only a sales and trading capability, but also a research sales capability. So, more and more content distributed by this system that we have invested in as well. So, I think given the earlier returns we are feeling very positive about the ability, not only our ability to do that, but the potential for it to drop to the bottom line.

But I don't want to leave you with a misimpression that we will not be aggressively repurchasing our shares at these stock prices. I think that with the lack of any amortization of debt, and the flexibility we now have with the credit line, and our history over the past year of repatriating, as Steve said, 130% of our operating earnings, expect us to do something very similar. We did a big deal in the context of all that this year.

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

That is helpful. Thanks for taking my questions.

Operator

Your next question comes from the line of Patrick O'Shaughnessy with Raymond James. Please proceed.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Hey, good morning guys. So, digging into your expenses a little bit, can you help me walk through what the incremental expenses in the quarter from Majestic were, and where they show up? I am guessing primarily it's in compensation and occupancy.

Steve Vigliotti - *Investment Technology Group - CFO*

Yes, as I mentioned in my prepared remarks, in addition to the $5 million of revenue for the two month period, there was about $4.8 million of operating expenses during that two months ago, with a substantial portion of that being compensation.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Thank you for clarifying that for me. So, I guess that, even ex-Majestic, your expenses came in a little bit higher than what I was expecting, and I'm guessing what the Street was expecting, too. How much of that was some seasonality? Maybe a higher fourth quarter cost, versus how much was just, you know, you still continue to grow the business so you need to make investments in it?

Steve Vigliotti - *Investment Technology Group - CFO*

There were a couple of items that we carved out in the press release that we included in our adjusted operating earnings numbers. So that included severance of $1.7 million, and a historical reserve we have to put on for a tax contingency of $2 million that showed up in G&A. So those two things certainly contributed to it.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Alright. Fair enough. Touching on the revenue side of Majestic, what sort of success have you guys had so far with going into clients and saying, hey, you used in the past "X" (inaudible), now we have this new research capability, how about you pay us a little bit more? You know, moving up the rate card with these guys. What sort of traction have you gotten with those conversations?

Bob Gasser - *Investment Technology Group - CEO and President*

As I've said, we are really pleased with the integration of the product, and not only that, but pleased with the integration of that into our economic arrangements in relationships with our client base. So, we feel very good about the outcome there relative to our expectations.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Okay. Got you. Then one last one for me. You talked about how you are having discussions where clients are instead just paying for the subscription to Majestic, or now, I have to do research, that going forward, they are going to start to pay you a little bit more through commission so, from a modeling perspective, would I expect to see reccuring revenues decline over time and that revenue move in to the commissions line item?

Steve Vigliotti - *Investment Technology Group - CFO*

Yes, you would. There are potentially three different ways we can get paid. One is through either hard dollars or through a third party CSA provider which would show up on our recurring revenue line. Another method is that clients could transfer their CSA arrangements over to ITG, in which case the recurring revenue amount, the subscription value, would still be recurring but anything over and above that for the CSA trading would show up in commissions. And lastly, the overall or combined commission arrangement, we'll basically take the entire amount out of subscription revenue and move up into the commission income.

Patrick O'Shaughnessy - *Raymond James - Analyst*

Helpful. Thank you.

Operator

Your next question comes from the line of Rob Rutschow with CLSA.

Robert Rutschow - *Calyon Securities Inc. - Analyst*

Hey, good morning.

Bob Gasser - *Investment Technology Group - CEO and President*

Hey Rob, good morning.

Robert Rutschow - *Calyon Securities Inc. - Analyst*

So, I guess to try to put a finer point on the expense line. Total non-comp I guess is around $70 million, let's call it, excluding the items that you identified, so like a $280 million annual run rate. So is that a number that we should look for in 2011, or can you give us some idea directionally what to expect?

Steve Vigliotti - *Investment Technology Group - CFO*

I think for the non-comp expenses, certainly you would be pulling out the one item we mentioned in G&A would be appropriate, and you model it going forward. And within comp, certainly there is no reason -- we'll continue to have the same level of severance going. So I think that's right.

Robert Rutschow - *Calyon Securities Inc. - Analyst*

So, can you give us an idea of what sort of growth rate we should look for in those noncomp expenses?

Steve Vigliotti - *Investment Technology Group - CFO*

I think Q4 levels, a slight increase over Q4 levels would be appropriate for your modeling, excluding those items.

Robert Rutschow - *Calyon Securities Inc. - Analyst*

Okay. I apologize if I missed this but the tax rate with was down a little bit, presumably because of lower US earnings. Should we expect that to pick back up if you see a rebound in US earnings?

Steve Vigliotti - *Investment Technology Group - CFO*

Yes.

Robert Rutschow - *Calyon Securities Inc. - Analyst*

Okay. And lastly, you talked about a mix shift in terms of your volumes, getting more from some of the sell side clients that you have. Can you talk about where you are seeing penetration and growth in that particular segment? And maybe --

THOMSON REUTERS

Bob Gasser - *Investment Technology Group - CEO and President*

Yeah. That is a very interesting segment right now, and I think what we're seeing, I think it's obviously part of the second derivative of the things we've talked about here on the call, Is that I think there's a number of boutiques and some large firms now that are looking at their infrastructure whether or not it's algos or smart routing, overall execution infrastructure. And they're saying, do I really need to be best of breed, or best of class? From a proprietary perspective. Or can I rely on someone else to manage this for me?

And I think we are seeing more and more opportunities, not only here in the US, but globally, to take over that piece of the business for a number of increasingly large broker dealers. So we're feeling pretty good about the sell-side business and its potential. It clearly softened the blow in terms of overall volumes in 2010 because of the pure weakness that I think the institutional market experienced. But we are seeing more and more opportunities like that to use a generalization.

Robert Rutschow - *Calyon Securities Inc. - Analyst*

And I guess, how do you avoid some of the problems that you had in the past with gaming and you know, lastly if you can give us any sort of idea as to what the contribution from the sell-side clients would be?

Bob Gasser - *Investment Technology Group - CEO and President*

So gaming, you mean gaming, in terms of access to POSIT and others ?

Robert Rutschow - *Calyon Securities Inc. - Analyst*

Yes.

Bob Gasser - *Investment Technology Group - CEO and President*

I would say we are careful about who we're partnering with. We want to make sure that we're not going to cannibalize existing business, that that's not going to create -- and we are also very careful in terms of access, and obviously the completeness of the product suite. But smart routing doesn't pose a lot of issues. The simpler mainstream algorithms don't pose a lot of issues. Clearly if we gave someone POSIT Alert that would be a big strategic mistake on our part. So we're not going to do that. But we clearly can give them enough functionality, enough infrastructure, and enough capability to go out and ring the register effectively.

Robert Rutschow - *Calyon Securities Inc. - Analyst*

And any --

Bob Gasser - *Investment Technology Group - CEO and President*

In terms of mix?

Robert Rutschow - *Calyon Securities Inc. - Analyst*

Yeah.

Bob Gasser - *Investment Technology Group - CEO and President*

Something we obviously track internally, but I don't think we are in a position to break that out.

Robert Rutschow - *Calyon Securities Inc. - Analyst*

Okay. Thanks a lot.

Bob Gasser - *Investment Technology Group - CEO and President*

Thank you.

Operator

We have no more questions in the queue at this time. I would like to turn the call over for management for closing remarks.

Bob Gasser - *Investment Technology Group - CEO and President*

Thank you very much for joining us this morning. We look forward to the Q1 2011 call.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This concludes our presentation. You may now disconnect. Have a good day.