



Bats Global Markets, Inc.

2nd Quarter 2016 Earnings Call

August 4, 2016

(SLIDE 1 – COVER)

Operator introduction: Greetings, and welcome to the BATS Global Markets Second Quarter 2016 Earnings Conference Call.

At this time, all participants are in a listen only mode. A question and answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star zero on your telephone keypad. As a reminder, this conference is being recorded. It is now my pleasure to introduce your host Mark Marriott, Director of Investor Relations for BATS.

Please go ahead, sir.

(SLIDE 2)

MARK MARRIOTT: Thank you, Kevin, and good morning everyone. Our CEO, Chris Concannon, leads the call today along with our CFO, Brian Schell.

As part of today's discussion, we will reference our second quarter 2016 earnings presentation, accessible via our website at ir.bats.com.

(SLIDE 3)

Our comments will include mention of non-GAAP financial measures, which are defined on slide 3 and reconciled in the appendix to the presentation. While we believe these financial measures provide investors useful information about our business trends, they do not replace and are not superior to GAAP measures.

Certain statements in the prepared presentation may relate to future events and expectations and, as such, constitute forward-looking statements. Actual results may differ materially from those projected in these forward-looking statements.

After our prepared remarks from Chris and Brian, we will open up it up to any questions you may have.

With that, I will pass it to Chris.

CHRIS CONCANNON: Thanks Mark. Good morning everyone and thank you for joining.

(SLIDE 4)

I'll begin on slide 4.

The second quarter of 2016 was another strong quarter for Bats as we recorded net revenue of \$110 million, net income of \$18 million, and diluted earnings per share of 19 cents. Normalized EBITDA was \$71 million, normalized EBITDA margin was 65%, adjusted earnings were \$34 million, and diluted adjusted earnings per share were 35 cents. Despite lower industry market volumes across all asset classes when compared to the first quarter, we were able to deliver exceptional results.

While achieving these numbers, we also built upon our market leading positions. In the second quarter, we maintained our position as the #1 exchange in U.S. Equities trading, excluding auctions, and remained the #1 market in ETF trading. We also remained #1 in European Equities trading and European trade reporting. In U.S. Options, while we are the 4th largest options exchange operator, we remained the #1 price-time priority market and the market leader in single-leg equity options trades, while also reporting record market share during the quarter.

In addition, we made progress on several key initiatives. First, we continued to see success in our ETF Listing Business, as we welcomed 23 new ETF listings and 3 ETF transfers to the Bats ETF Marketplace. We also welcomed four new issuers to our market during the quarter. The 23 new listings accounted for 28% market share of new listings coming to market compared to a 6% share last year during the second quarter.

Second, as we continue to grow market share in our U.S. Options business, we remain on track to deliver auctions capability on our EDGX Options Exchange by the end of this year. The first part of the auctions rollout occurred on July 11th and the remaining capabilities will be completed by the end of 2016, bringing important new functionality to our market as we broaden our options offering. Similarly, we remain on schedule to launch FX forwards on our Hotspot platform by year end, delivering on a promise we made when we purchased this asset in 2015.

In addition, we continue to make headway in growing non-transaction revenue, adding new, significant customers in June to our Bats proprietary market data products. Non-transaction revenue continues to make up more than 55% of our net revenue and was

responsible for 68% of the total net revenue growth in the second quarter compared to a year ago.

Another key initiative during the quarter was our launch of UK benchmark index products in Europe. The new UK index series includes 18 different index products covering large to small cap securities across 12 industry sectors. These products are published by Bats Europe in real-time, a contrast to competitive offerings, which are provided with a 15-minute delay.

Also, at the end of June, we were able to successfully refinance our existing term loans to take advantage of our improved credit profile and favorable market conditions. Brian will provide more details on this topic shortly.

Most importantly, we continue to be well-positioned to grow all of our businesses by focusing on our customers' needs and working to become – or remain – #1 in every market in which we operate.

(SLIDE 5)

Turning to slide 5.

U.S. Options, which continues to be a great growth story, reached record market share of 11.6% for the quarter versus 9.7% a year ago and 10.2% in the first quarter. This growth is especially impressive as we nearly doubled net capture to \$0.049 in the second quarter from \$0.026 last year. And, again, we remained the #1 price-time priority options market with market share of 42.3% of that segment in the second quarter and were also the market leader in single-leg equity options trades with 17.0% market

share. The big news in the second half of this year will be the launch of the remainder of our auction capabilities on the new EDGX Options Exchange.

Second quarter market share in our U.S. Equities business was slightly lower than a year ago at 20.4% vs. 20.8%. While not pleased with that slight decline, we maintained our leadership position for U.S. ETF trading with market share of 24.7% for the quarter, a distinction we have held since February 2014.

European Equities market share ended the quarter at 22.9% vs 24.6% a year ago, offset by a 15% year-on-year increase in net capture due to pricing changes implemented earlier this year. The pricing changes are working as intended, improving net capture even as we maintain aggressive prices as compared to our major European competitors.

Further on the European front, I'd like to briefly mention the potential impact of Brexit on our business. First, we believe that, as a small and nimble company, Bats is uniquely positioned to respond to Brexit. In the short term, we expect to see episodic volatility and volume spikes as the U.K. begins the 2 or 3 year process to leave the EU. Longer term, we may choose to establish a small office and registration within an EU country while we maintain the majority of our operations in London.

As for the Global FX business, overall market volumes pulled back in the second quarter due to a lack of volatility but our market share for the quarter was steady at 11.6%, an increase of 60 basis points compared to last year.

With that, I'll pass it to Brian.

(SLIDE 6)

BRIAN SCHELL: Thank you, Chris. I'll begin with slide 6. As highlighted earlier, second quarter net revenue grew by 11% to \$110 million from \$99 million a year ago. Net income decreased slightly to \$18 million from \$20 million a year ago, with the decline reflecting, among other items, a pretax charge of \$18 million incurred as a result of refinancing our existing credit agreement.

Before I continue, let me point out that our second quarter GAAP results include certain items that impact the comparison of our operating results and that we believe are not indicative of our core operating performance. These items are detailed in our "Reconciliation of Non-GAAP Measures" provided in the appendix of our earnings presentation materials as well as in the earnings press release.

(SLIDE 7)

Now, turning to the next slide,

I want to highlight our organic net revenue growth rate of 11% for the quarter and 18% year-to-date. Part of this growth was the result of the run-rate benefit of connectivity fee pricing changes implemented in during 2015. The remainder of the variance/ was driven by higher net capture in our European Equities and U.S. Options businesses/ and higher market volumes in our U.S. Equities and U.S. Options businesses.

For the quarter, our percentage of non-transaction revenue again made up the majority of our net revenue, coming in at nearly 56%, almost 2 percentage points higher than the second quarter last year of 54%. As such, non-transaction revenue growth out-paced

transaction revenue growth and actually made up 68% of our total net revenue growth compared to a year ago.

From a segment perspective, U.S. Equities was responsible for 60% of net revenue growth followed by U.S. Options contributing 45%. The U.S. Equities growth was driven by an increase in proprietary market data and connectivity fees; the U.S. Options growth was due to a strong increase in net capture and record market share.

(SLIDE 8)

Moving to slide 8, total operating expenses were \$52 million compared to \$50 million last year. However; normalized operating expenses decreased slightly to \$50 million, as Direct Edge synergies offset increases in compensation and benefits along with an increase in G&A expenses, due to a one-time operating tax credit recorded last year.

We continue to realize synergies from both the Direct Edge and Hotspot acquisitions. In the quarter, we realized \$11 million of synergies from the Direct Edge transaction and nearly \$2 million for Hotspot.

For full year 2016, we are providing guidance for total operating expenses of our current operations to be in the range of \$205 million to \$215 million.

Our effective tax rate for the quarter was 40.7% compared to 43.6% last year due to lower effective state income tax rates.

(SLIDE 9)

Turning to the next slide, a few additional comments about our earnings. Diluted earnings per share fell to 19 cents per share compared to 21 cents per share last year, a decrease of 10%, reflecting the previously mentioned pretax charge for the early extinguishment of debt.

However; adjusted earnings for the quarter, which exclude special charges including IPO, acquisition-related and debt restructuring costs as well as acquisition-related amortization, grew to \$34 million compared to \$25 million last year, which is a 38% increase. On a diluted per share basis, adjusted earnings increased 35% to 35 cents per share compared to 26 cents last year.

Normalized EBITDA for the second quarter was \$71 million compared to \$60 million last year, a 19% increase. The normalized EBITDA margin increased by 440 basis points to 65% and the effective normalized EBITDA margin on incremental net revenue growth was more than 100% from the year-ago quarter.

From a segment perspective, the majority of our earnings growth came from U.S. Equities, reflecting the combination of the top-line growth drivers and Direct Edge synergies previously mentioned.

In U.S. Options, normalized EBITDA grew by more than 100% to nearly \$6 million, again driven by nearly doubling net capture/ and record market share.

(SLIDE 10)

Now on to a few balance sheet metrics on slide 10. By the end of the second quarter, we reduced our leverage ratio to 2.3 times, well below the covenant maximum of 4

times. As mentioned earlier, we refinanced our credit agreement to take advantage of our stronger credit profile as a public company and a lower interest rate environment. The refinancing also allowed us to lower our interest rate spread by nearly 150 basis points, reducing interest expense by approximately \$7 million for the remainder of 2016 and by nearly \$11 million for full year 2017. In addition, we also significantly reduced the mandatory annual amortization payments, thereby providing us with additional capital allocation flexibility. And as part of our capital allocation plan/ and as previously announced on our last earnings call,/ we plan to initiate our first regular quarterly cash dividend of 8-cents per share, payable next month on September 28th to stockholders of record at the close of business on September 14th.

And finally, our adjusted cash, which is the sum of our cash and financial investments excluding the cash we've collected for Section 31 fees, was \$62 million as of June 30th. Regarding capital expenditures, we spent \$5 million in the second quarter and will maintain our annual capital expenditures guidance for 2016 of \$15 to \$20 million.

With that, I'll pass it back to Chris to summarize the call.

(SLIDE 11 – SUMMARY)

CHRIS CONCANNON: Thank you Brian. I'll quickly refer to slide 11 for a recap.

Here is what we have done well this quarter:

- We achieved organic net revenue growth of 11% for the quarter and 18% year-to-date;
- We set a record for market share in U.S. Options at 11.6%;

- We remained the #1 stock exchange in Europe while increasing our net capture rate;
- We continued to have success in our ETF Trading and Listing business;
- We remained on track to deliver new products within our U.S. Options and Global FX businesses;
- And we successfully refinanced our debt to improve our ongoing net income and provide more capital allocation flexibility.

While we had another strong quarter, here is where we can do better:

- First, while we continue to be encouraged that the FX industry is undergoing the structural changes that we anticipated, we continue to be disappointed by our growth of Hotspot revenue and volumes; we plan to change this by focusing on market share growth and increasing our product offering;
- Second, we have rapidly grown our head count to 323 people. We now have to ensure that our recently added employees are running at full capacity before we experience additional growth in those areas of our company; we want to avoid a big company mentality and remain nimble and responsive to market opportunities;
- Third, while we remain one of the most efficient exchange operators on the planet, I think we can continue to focus on our expenses and continue to grow the gap between us and our competitors;
- Finally, with respect to our acquisition of ETF.com, Bats is accustomed to fully integrating companies that it acquires and we specifically chose not to fully integrate ETF.com given its business model. However, we need to increase the possibility for revenue synergies and growth strategies between ETF.com and our ETF Trading and Listing business. I expect more to come from this asset in the coming year and beyond.

With that, I want to thank you for joining our call today. I will now hand the call back to the operator to begin the Q&A.