Flow Traders Q2 & H1 2021 Results

Friday, 23 July 2021

Transcript produced by Global Lingo
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Operator: Hello, and welcome to the Flow Traders' Q2 21 Results Call. My name is Molly, and I'll be your coordinator for today's event. Please note that this call is being recorded, and for the duration of the call, your lines will be on listen-only. However, you will have the opportunity to ask questions. This can be done by pressing star one on your telephone keypad to register your question at any time. If you require assistance at any point, please press star zero and you will be connected to an operator.

I will now hand you over to Jonathan Berger to begin today's conference. Thank you.

Jonathan Berger: Thank you. Good morning, everyone, and thank you for joining Flow Traders' second quarter and half year 2021 results call. As you've no doubt already seen we released our results first thing this morning. I'm joined here on the call by Flow Traders' CEO, Dennis Dijkstra, as well as Chief Trading Officer, Folkert Joling, who will run through the results presentation. Afterwards, they will be happy to take any questions that you may have.

Before we begin, let me draw your attention to the disclaimer on page two. Please be advised that if you continue to listen to this presentation, you are bound by this disclaimer. Also please note that the results we will discuss in this presentation are unaudited.

With the formalities out of the way, I would now like to hand over to Dennis for his opening remarks.

Dennis Dijkstra: Thank you, Jonathan. Good morning, and thank you all for joining this call where we will provide additional colour on our second quarter and half year 2021 results. The first half of 2021 overall saw more normalised levels of market activity when compared to the exceptional market circumstances experienced in 2020. Accordingly, market ETP value traded decreased 14% year-over-year.

The second quarter of 2021 was more subdued than the first, and this was reflected in the ETP market value traded, which decreased by 14% quarter-on-quarter. Our own ETP value traded essentially tracks the broader markets in the second quarter, decreasing by 15%. From a year-on-year perspective, Flow Traders only decreased by 6%, which clearly outperformed the broader market.

Consequently, this market environment, along with Flow Traders' own pricing and hedging capabilities, translated into a net trading income of €94.4 million in the second quarter of 2021 compared to €142.2 million in the first quarter of 2021 and €229.9 million in the second quarter of 2020. This contributed to NTI for the first half as a whole of €236.6 million.

We demonstrated yet again strong margins with the EBITDA margin of 43% in the second quarter of 2021 with an EBITDA of €40.3 million. Overall, in the first half of 2021, our EBITDA was €119.6 million with a margin of 51%. The second quarter 2021 net profit amounted to €28.7 million with a basic earnings per share of €0.66. Ultimately, we reported a net profit for the first half of 2021 of €90.2 million with a basic earnings per share of €2.05.

Taking all of this into account, Flow Traders proposes an interim dividend for 2021 of €1 with an interim dividend pay-out ratio in line with with the prior years. This will be paid on 20th August. We are cautiously monitoring the evolution of the pandemic and our business continuity plan remains active with the health and well-being of our colleagues being of the upmost importance.

We once again retained a strong focus on implementing our strategic growth agenda during the second quarter, which is further confirmation of our structural growth. Accordingly, we have worked to enlarge out ETP footprint and have taken first steps in enhancing coverage of fixed income, cryptocurrency and commodity markets. These investments are positively contributing to the top line and we expect even greater contributions going forward.

Now, let's take a closer look at the market developments as well as a deeper dive into Flow Traders' performance and accomplishments. Firstly, we will review recent ETP market dynamics on the next slide. As shown at the top left-hand side of this slide, ETP market value traded declined 14% in the second quarter of 2021 compared to the first quarter as markets further normalised.

Market volumes for the first half of 2021 were also 14% lower compared to the same period in 2020. The implied volatility also trended downwards during the second quarter from the higher levels seen in the first. Accordingly, this reduced market velocity in the second quarter after uptick seen in the first. ETP assets under management surpassed the $7 trillion mark for the first time in the first half year predominantly driven by equity ETFs.

The first half also saw record ESG and crypto inflows. Naturally, as a key part of the ETP ecosystem, Flow Traders facilitated trading across all these ETP asset classes. In summary, it is fair to say that momentum and the outlook in the ETP universe remained extremely positive in the first half.

Now I will hand over to Folkert, who will review Flow Traders' regional performance in greater detail on the next slide.

Folkert Joling: Thank you, Dennis, and good morning, all. On this slide, we present an overview of some of the key performance indicators for the second quarter and for the first half 2021 on a regional basis.

As Dennis mentioned earlier, Q2 was more subdued generally from a market activity standpoint and that is very much reflected in the performance by region. Encouragingly, our own ETP value traded outperformed the market in every region in Q2.

In Europe, we maintained our position as the leading liquidity provider in ETPs both on and off-exchange. The region delivered a robust trading performance in Q2 with contribution from crypto market making activities. And once again, Europe remains the largest NTI contributor and Flow Traders' most important market. In a consistent theme across all of our regions we have sought to deepen and expand our overall footprint.

In Europe, we opened a new office in Paris, partnered with TP ICAP and the launch of new crypto platform and successfully connected to Bloomberg's digital platform.

Moving to the Americas, again, the trading performance reflects lower levels of market activity. The Americas remain a growth region, and accordingly, we continue to expand our Lead Market Maker activities with issuers as evidenced by iShares ESG ETFs. From a footprint perspective, we connected with additional counterparties and our Single Dealer Platform went live and also commenced coverage of Grayscale products and Canadian crypto ETPs.

Lastly, in APAC, we were active in equity exposure trading for counterparties across all major US ETFs on a 24/5 basis. In terms of building out our footprint, and as an example, we acted as a Market Maker in a newly launched CNH future on Hong Kong Exchange. And we have submitted our QFII registration for China trading.

I will now hand over to Dennis for the next slide, where we cover the cost base in greater detail.

Dennis Dijkstra: Thanks, Folkert. The main drivers of the 8% year-over-year and 4% quarter-on-quarter increases in fixed expenses relate to new hires and technology investments. We have incurred in the first half of €1.3 million of additional one-off expenses in the first half, which relates primarily to the ongoing COVID-19-related expenses.

Our headcount increased by 2% versus the end of the Q1 quarter with a focus on technology and development hires to support growth in product coverage, asset classes and trading platforms connected to. The business overall continues to demonstrate healthy EBITDA margins. In terms of cost for the full year, we still expect a maximum growth in fixed operating expenses of circa 15% for 2021.

Now we will take a closer look at Flow Traders' capital position on the next slide. We show our required CET1 capital levels on the top left-hand part of the slide. After accounting for the interim dividend, Flow Traders' capital buffers have remained strong and remain comfortably above all requirements under CRR or IFR.

Our own fund requirements increased to €271 million at the end of June from €226 million at the end of March. This reflects the nature of the trading book at that point in time with increased crypto and fixed income trading. We had a total CET1 of €449 million at the end of June 2021. On the top right-hand side of the slide, you can see that our solvency ratio with the Prime Brokers as at 30th June reduced slightly from the end of first quarter, reflecting a reduction accumulated trading capital to €619 million. Again, we are comfortably above our Prime Broker requirements.

The new IFD/IFR prudential regime finally came into force on 26th June 2021. The initial impact has been broadly neutral as lower capital requirements have been partly offset by growth business activities, which are more capital intense. We remain in ongoing discussions with the DNB as to the precise implementation of these new requirements.

Considering all these developments, Flow Traders has set the full year 2021 interim dividend at €1 per share.

Now I will hand over to Folkert again to discuss our strategy in medium term growth focus areas.

Folkert Joling: Thank you, Dennis. This slide will be familiar to all of you. And again, our growth focus areas remain as we outlined previously. Recent developments during the first half of the year have further confirmed our strategy where the structural growth in the business very much confirmed. Seeking to enlarge our global ETP footprint means that we can align ourselves with the structural growth in passive investments, which has continued apace in H1.

ETP assets under management surpassed the $7 trillion mark for the first time in H1. We have also seen record inflows into ESG and crypto which has translated into increased trading activity in those areas. Our goal is to remain market leader in Europe and seek to be top five in the US.

In terms of enhancing our coverage of fixed income, we want to build on the fact that fixed income continues to be a growing ETP asset class by becoming the global footprint liquidity provider in fixed income ETPs. We will also leverage access to the underlying. This will be done through promoting and driving market electronification, which will create a more level-playing field.

From a currency trading perspective, we are leveraging our global infrastructure to provide liquidity to currency pools and counterparties. Our aim is to be top 15 FX liquidity provider on Euromoney and we want to grow commodities by leveraging our top five rank on ECNs for spot metals.

Lastly, we will further develop our crypto business by unlocking additional liquidity pools and maintaining our number one market maker position in crypto ETPs in Europe. These growth focus areas have the ultimate goal of driving structural NTI growth.

I will now turn to the final slide of the presentation and review our strategic progress so far in 2021. As Dennis mentioned earlier in the presentation, we once again retained a strong focus on implementing our strategic growth agenda during the second quarter. We are confident of delivering additional progress during the remainder of 2021. In the first half of the year, Flow Traders built on our leading global ETP liquidity provider position and grew our presence in all regions, especially in the US and Asia.

Highlights include acting as a lead market maker on an increasing number of new issuers in the US commencing coverage of Grayscale products and Canadian crypto ETPs and further deepening our ecosystem relationships in APAC. Globally, we now trade around 1,900 institutional counterparties. In the second half, we will focus further on expanding our counterparty base as well as increasing and deepening product coverage connecting with additional venues and following up on our QFII registration.

We have enhanced coverage of fixed income in the first half of the year through expanding our infrastructure and we have retained our number one off-exchange position in fixed income ETFs. Focus for the rest of the year is on further enhancing our pricing capabilities as well as accessing more liquidity and increasing volumes as well.

From a currency and crypto perspective, we are now constantly trading more than $5 billion daily as we build bilateral connectivity and trade processing. During the first half of the year, we had successfully completed our connectivity migration to increase our counterparty reach and partnered with ICAP and the launch of crypto trading platform. Work will continue in the second half and scaling FX bilateral counterparty business and increasing our product coverage.

I will now hand back to Jonathan for the rest of the call.

Jonathan Berger: Thanks, Folkert. This now concludes the formal part of our presentation. We'd now like to open up the floor for any questions you may have. Operator?

Questions and Answers

Operator: Thank you. As a reminder, if you would like to ask a question, please press. Please ensure that your line is unmuted locally. You'll then be advised when to go ahead with your question. The first question today comes from the line of Thomas Couvreur calling from KBC Securities. Please go ahead.

Thomas Couvreur (KBC Securities): Hi. Good morning. Yes, thank you for taking my questions. Maybe the first one on competitive pressure. I think during the third quarter, you mentioned that the lower volatility levels in that quarter caused a lot of competitors to re-enter the market compared to earlier in the year, which weighed heavily on the results then this quarter despite the significantly lower volatility. We're not really seeing that effect and with NTI still quite a bit higher than third quarter. Did something change in terms of like the competitive landscape, or is this difference more linked to your increased footprints or the type of products traded – yeah, any comments on that would be helpful. And then maybe a second question. Yeah, maybe a bit more general. With the VIX levels now back around longer term averages and no specific events in this quarter like the COVID-linked sell-offs or the sector rotation that we saw in the first quarter, would it be fair to say that Q2 is, yeah, sort of a standard quarter for you and maybe a good basis to extrapolate from going forward? Or are you still seeing some elevated and thus unsustainable activity coming from COVID? Thank you.

Dennis Dijkstra: On the – thanks for the questions, by the away. I think on the competitive landscape, we have not seen any big changes in the last three to six months in either region. I don't know, Folkert, if you can add anything there but –

Folkert Joling: No. I agree. There haven't been any major changes in the competitive landscape.

Dennis Dijkstra: Anywhere. So – and on your second question on the lower volatility environment, I think the second quarter demonstrated that the investments we've done in the last few years on diversifying but also increasing the footprint focusing on the right parts of the ETP ecosystem being ESG-related, fixed income-related and also crypto where the growth is. Also focusing on being incremental part of the growth in ETP not only historically but also going forward in addition to any investments we've done in improving pricing but also diversification into our asset classes started to pay off.

So also there, the purpose of those investments is to also structurally grow our NTI into a more asset class as more products broadening the the investor base we're connected to in every region. It's hard to say whether this is a normal quarter, but I think it's just a confirmation of the focus and the investments we've been doing in the last few years.

Folkert Joling: The VIX index obviously describes the implied volatility for the S&P index and we're trading many more asset class in different products. So it hasn't been a standard quarter. I think if you look at all the different asset classes, probably it's difficult to say that for instance on the crypto side and the fixed income side. So we look at more indicators for that. So that equity was relatively quiet but fixed income was even more quiet. And compensated a bit on the crypto and it was pretty active mostly in May as well with some downticks. It's a mix.

Thomas Couvreur: And maybe as a short follow-up on that, and I think the question has been asked in previous calls as well, so apologies for re-asking that. But on crypto, any plans to maybe provide some additional colour or guidance on that financially I mean?

Dennis Dijkstra: No. Answer is going to be the same as in for the previous questions. We don't disclose NTI or contributions to NTI for asset classes yet.

Thomas Couvreur: Yeah. That's clear. No problem. Thanks.

Operator: The next question comes from the line of Michael Roeg calling from Degroof Petercam. Please go ahead.

Michael Roeg (Degroof Petercam): Yes, good morning, gentlemen. I have a couple of questions on China, where you filed for approval to trade. How long does such a filing generally last? Is it a couple of months? Or could you perhaps take a year before you can start trading? Then second. Once approved, how much of that Chinese market is then addressable for you? Is it all of it or only parts? And then finally, is revenue capture there roughly comparable to that of APAC?

Dennis Dijkstra: Good morning, Michael, and thanks for the questions. So the QFII registration was filed a couple of weeks ago. We expect an answer reasonably soon that this will allow us to start trading some of the exchanges remotely. But it is expected that we need to follow-up probably with more onshore presence down the road to really cover all exchanges in China mainland. So this is a very important first step towards trading more China onshore market. So it's hard to say anything about the revenue capture that's available for us. But we do see that it is a very significant market. It's a high growth market and also they're teaming up with other markets participants. This should be a very nice growth opportunity.

Michael Roeg: Okay. So then since you'll be starting remotely, is it fair to assume that you can only address a certain part of the market and once you have an office there, all of it could be open to you?

Dennis Dijkstra: Yes.

Michael Roeg: Okay. Well, continuing on onshore presence, now a nasty question. How will you protect your IP?

Dennis Dijkstra: Well, we trade many asset classes and in many countries, right. So we take security in the cyber security very, very seriously. So we have the ability separate entry points to any market from the core and isolate it. China is still the only market which might have a perceived higher level of security. So that's something we have been dealing with and also, we'll deal with going forward.

Michael Roeg: Okay. Clear. Well, and then I also have a question on crypto. And I think in previous calls, you didn't quantify it of course, but you – I think it was also downplayed by suggesting that it's contributing but it's not huge within the NTI as a whole. However, my perception is that crypto in general is volatile but in Q2 it was even more volatile than usual. So having said that, it was probably relatively modest in your NTI in Q1 and also in Q2. But quarter-on-quarter was there quite a good improvement because of that increased volatility or would that also be too much for you to disclose?

Folkert Joling: That would be a bit too much. What we can say on the focus it receives is that this market is developing pretty rapidly also impacting the entire financial ecosystem. And that's also a reason that we are active and present and following everything that's happening because it will change some of the process in the financial world. So we have a relatively strong team monitoring this because we expect this to have a lot of impact going forward. But we're not going to talk about all the NTI growth here.

Michael Roeg: Okay. Well, too bad on that. And given those huge swings that we've seen in the past few weeks and months, that hasn't resulted in any kind of inconsistent trades or losses or the model is working fine in spite of bitcoin halving in the couple of weeks?

Folkert Joling: You mean 30% down on a day?

Michael Roeg: Yeah. That is not all of a sudden leading to missed trades on your part. Everything is working fine. Your model is indeed able to digest all of that?

Folkert Joling: We didn't have a loss on that day. The exchange is obviously not that mature. So the trade capture and the stability of the platforms is slightly less than regulated exchanges. So this is something we have to deal with. But on our positioning or risk side, we have not encountered any problems.

Michael Roeg: Okay. Good. That's reassuring. That's it from my side. Thank you.

Dennis Dijkstra: Thank you.

Operator: The next question comes from the line of Lotte Timmermans calling from ABN AMRO ODD BHF. Please go ahead.

Lotte Timmermans (ABN AMRO): Good morning, gentlemen. One question left from my side on US revenue capture. It was a bit light, especially compared to last quarter. And now you profited from some good fixed income flows last quarter, also supported by strong creation and redemption activity. What share would have been relating to this activity in Q1? And could you say anything about potential pricing pressure or market share going forward in the US?

Folkert Joling: Yes. So indeed the lower activities in the fixed income play a role here. But it's not the only factor in the market. If you look at the equity side, it's broadly divided into an international segment where we do really well and the KPIs look in line with what we want, maybe a bit higher. Then we have the domestic side where they're slightly behind. So we're working on that as well.

And in that areas, there is a lot of volume. So the impacts for instance the market share metric if you would look at that one, let's call it, isolated. So it is a combination of the way that behaviour of the market is for such strategies. So it's a bit of both. It's bit on the lower activity on the fixed income and slightly more challenging environment on the domestic side, which is traditionally not our strongest point but on the international side we're doing pretty well. So I think it's looking good still. We want it to be slightly better, so that the thing its slightly below our expectations. Yeah, hopefully next quarter we can update that is back in line again because there is definitely growth still visible on the longer term trend.

Lotte Timmermans: So not any structural issues or pricing pressure there? Just market-related slowing down of the market and less disruptions?

Folkert Joling: Yes.

Lotte Timmermans: Okay. Thanks.

Operator: The next question comes from the line of Martin Price calling from Jefferies. Please go ahead.

Martin Price (Jefferies): Good morning, guys. Thanks for taking my questions. I've got two, if I may. The first one is just on capital. Just wondering if you can provide some quantification of how much lower the new capital requirements are relative to the old regime and perhaps assuming the trading book unchanged. And are you hopeful of much further capital relief as a result of the discussions that you're having currently with the DNB?

And secondly just on China. Would establishing an onshore presence result in any noteworthy uptick in capital needs or investment requirements perhaps relative to your existing cost guidance? Thank you.

Dennis Dijkstra: On the capital, as the new IFR regulation is relatively new, so we're still kind of finalising some nitty-gritty details with the regulators. So both of us want to start with a conservative approach. So hopefully – and we're confident as always, but there are opportunities to get more proportionate for also the market risk we actually take and have on our balance sheet.

So I think also historically we were expecting and also the new regulation was aimed to have more kind of proportionate to capital requirements, so having capital requirements which are reasonably aligned – yeah, I think it can be more – a bit more sophisticated.

So we are confident we can lower it. So it is in line and it differs with the positions, but it's – there is no big swing. So think about 5-10% range of the old capital requirement. And on your – the China question, it's relatively similar to any other office we will open whether it's UK or a bigger trading setup like Hong Kong or New York.

A big part of the infrastructure is already built, so all the trading applications. So opening a new office is predominantly about a slight increase in fixed costs like rents, probably some connectivity from a data perspective but no big capital or of course changes in the foreseeable future.

Martin Price: That is very helpful. Thanks, Dennis.

Operator: Before we move to the next question, please be reminded if you would like to ask a question, please press star one on your telephone keypad. The next question comes from the line of Michael Werner calling from UBS. Please go ahead.

Michael Werner (UBS): Thank you very much. And thanks for the presentation guys. Just two questions from me. One on the tax rate. I think the tax rate went up a bit in Q2 versus what we've seen over the past couple of quarters. I was just wondering if you can explain what was going on there?

And then second with regards to Flow Traders being the number one market share leader in crypto ETFs. I was wondering if there is a magnitude in terms of that market share that you can provide? Thanks.

Dennis Dijkstra: Thanks for the question. So on the tax rate, this has mainly to do with the tax treatment of equity or share compensation for the employees, which is to a certain degree not tax deductible in especially the Netherlands. So that's the reason for the slight uptick in Q2. We don't expect long-term any changes there, so the guidance of our effective tax rate of 20% remains in place, especially the longer term. The second question on the magnitude of the market share. I think.

Folkert Joling: So in most of the ETPs are listed in Europe at the moment and the rest of the world is slowly seeing more listings coming. So for instance in the US not yet. We have some other plans. So we're focusing on the ETPs here, so mostly Europe. So we are – on the whole of Europe we have market shares on exchange around 40% and off-exchange 20-high to 30%. For the cryptocurrency, it's slightly higher than that but there is not a huge number of things. It's a bit more variable because of the low number of listings but you can say between 35% and 45% more or less.

Michael Werner: Thank you very much. Very helpful. Cheers.

Operator: Thank you. We have no further questions coming through on the phone lines at this time. So I'd like to hand the call back over to your hosts. Thank you.

Jonathan Berger: Thank you, operator. I'd like to thank the analysts for participating in today's call. Please note that we'll host our next analyst call when we release our fourth quarter and full year's 2021 results early in 2022. Details of this call and the timing of this call will follow in due course. Our third quarter trading update is scheduled to be released on 28th October 2021. This now ends the call. Thanks again everybody and have a good day.

Operator: Thank you for joining today's call. You may now disconnect your lines. Hosts, please stay connected.

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