

## Virtu Financial

## 4Q23 Earnings – Subdued volatility and shifting retail preferences hurt results

Reiterate Rating: BUY | PO: 20.00 USD | Price: 17.46 USD

## Tale of two asset classes: crypto vs. equities

Earlier today, Virtu Financial (VIRT) reported \$0.27 of adjusted EPS, missing the \$0.37 consensus by 27%. The miss stemmed from the market-making segment where revenue hit a post-pandemic low. The weakness was driven by a retail pivot to sub-dollar equity trading and crypto in addition to lower spreads. Sub-dollar trading hit record levels in December while crypto volumes were up 90% q/q. Since VIRT's margins in sub-dollar stocks are especially thin and their current crypto mix is small relative to equities, overall market-making earnings ground lower in 4Q23.

## Forecast continued tailwinds from crypto ETF launches

Although crypto was a drag on 4Q23 results, the launch of 11 cryptocurrency ETFs in January should amount to a \$5-10M q/q tailwind in 1Q24. VIRT is an authorized participant and approved counterparty for all 11 ETFs. As such, VIRT will be able to (1) make markets in the ETF shares; (2) arbitrage the shares with spot crypto via the create/redeem mechanism; and (3) sell spot crypto into each issuer's trust. This will enable them to better monetize the asset class. Already, management noted that crypto's daily P&L contribution has increased to "meaningful six figures" in January from a de minimis amount last quarter.

## Lowering EPS &amp; PO due to the ongoing volatility drought

Despite January historically being one of the strongest months of the year for trading, 1Q24 is shaping up to be another tough quarter in equities, driving down our estimates. Industry equity volumes are down 6% m/m, and given that volatility remains near a multi-year low, we anticipate that revenue capture will be hurt by narrow spreads. We lower our 2024/2025/2026 EPS estimates to \$1.88/\$2.37/\$2.89 from \$2.25/\$2.83/\$3.21. We reduce our PO falls to \$20 from \$22, implying 15-20% total return potential.

## Reiterate Buy: Volatility normalization &amp; reg catalysts

We think the current entry point is particularly attractive given the recent negative news, cyclical trough trading backdrop, lack of long-only ownership and a depressed valuation at 5-6x 2025E EBITDA (and 15-20% cheaper than other capital-intensive financials such as banks & insurers). We anticipate VIRT's valuation will rerate upward as the regulatory concerns related to the SEC's equity market structure reforms dissipate. We also continue to expect volatility to normalize upward, which would help both volumes and revenue capture.

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	2.97	1.82	1.88	2.37	2.89
EPS Change (YoY)	-34.7%	-38.7%	3.3%	26.1%	21.9%
Consensus EPS (Bloomberg)			2.24	2.60	NA
DPS	0.96	0.96	0.96	0.96	0.96
Valuation (Dec)					
P/E	5.9x	9.6x	9.3x	7.4x	6.0x
Dividend Yield	5.5%	5.5%	5.5%	5.5%	5.5%

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Timestamp: 25 January 2024 06:24PM EST

25 January 2024

## Equity

## Key Changes

(US\$)	Previous	Current
Price Obj.	22.00	20.00
2024E Rev (m)	1,279.4	1,222.6
2025E Rev (m)	1,381.8	1,337.2
2026E Rev (m)	1,429.8	1,423.9
2024E EPS	2.25	1.88
2025E EPS	2.83	2.37
2026E EPS	3.21	2.89

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## Stock Data

Price	17.46 USD
Price Objective	20.00 USD
Date Established	25-Jan-2024
Investment Opinion	B-1-7
52-Week Range	16.26 USD -21.04 USD
Mkt Val / Shares Out (mn)	2,884 USD / 165.2
Free Float	94.0%
Average Daily Value	15.69 USD
BofA Ticker / Exchange	VIRT / NAS
Bloomberg / Reuters	VIRT US / VIRT.OQ
ROE (2024E)	20.3%
ESGMeter™	Medium

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See page 3 for a glossary of abbreviations used in the report.

# iQprofile<sup>SM</sup> Virtu Financial

## Income Statement Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Revenue	1,468	1,211	1,223	1,337	1,424
% Change	-23.2%	-17.5%	1.0%	9.4%	6.5%
Investment Advisory Fees	NA	NA	NA	NA	NA
Compensation & Benefits	(316)	(320)	(323)	(326)	(330)
% Change	0.6%	1.3%	1.0%	1.0%	1.0%
Non-Compensation Expenses	(360)	(386)	(414)	(431)	(449)
Net Income to Ordinary Shareholders	528	305	297	351	400
Adjusted Net Income (Operating)	528	305	297	351	400
% Change	-39.6%	-42.1%	-2.9%	18.3%	13.9%
Adjusted EBITDA (Operating)	858	568	551	648	717
Cash EPS	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA

## Performance Metrics (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Operating Margin	54.0%	41.7%	39.7%	43.4%	45.3%
Pre-Tax Profit Margin	47.8%	33.5%	31.8%	34.5%	36.9%
Net Profit Margin	36.0%	25.2%	24.3%	26.2%	28.1%
Comp Expense/Revenue	21.5%	26.4%	26.4%	24.4%	23.2%
Non-Comp Expense / Revenue	24.5%	31.9%	33.9%	32.2%	31.5%
Net Revenue Growth	-23.2%	-17.5%	1.0%	9.4%	6.5%
Operating Expense Growth	-0.3%	4.4%	4.4%	2.7%	2.7%

## Asset Management Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Assets Under Management (\$bn)	NA	NA	NA	NA	NA
% Change	NA	NA	NA	NA	NA
% Equity	NA	NA	NA	NA	NA
% Fixed Income	NA	NA	NA	NA	NA
% Money Mkt / Other	NA	NA	NA	NA	NA
Net New Flows (\$bn)	NA	NA	NA	NA	NA
Organic Growth	NA	NA	NA	NA	NA
Organic Growth ex-Money Market	NA	NA	NA	NA	NA
Advisory Fees / Avg. AUM	NA	NA	NA	NA	NA

## Balance Sheet Data (Dec)

(US\$ Millions)	2022A	2023A	2024E	2025E	2026E
Total Assets	10,583	17,582	17,561	17,604	17,706
Total Shareholders' Equity	1,651	1,474	1,453	1,497	1,598
Tangible Shareholders' Equity	NA	NA	NA	NA	NA
BVPS (Stated Equity)	NA	NA	NA	NA	NA
ROE (Stated Equity)	30.0%	19.5%	20.3%	23.8%	25.8%
Cash & Investments	NA	NA	NA	NA	NA
Net Cash & Investments Per Share	NA	NA	NA	NA	NA

## Company Sector

Other Financials

## Company Description

Virtu (VIRT) primarily operates as an electronic market maker, supplying liquidity to the global financial markets. Through its execution services segment, it also provides trading solutions to third-party asset managers and brokers. VIRT trades on venues in more than 50 countries and in most asset classes including global equities, ETFs, options, foreign exchange, futures, fixed income, cryptocurrencies and commodities.

## Investment Rationale

We view the current entry point as attractive given recent negative news, cyclical trough trading backdrop, lack of long-only ownership and a depressed valuation at 5-6x EBITDA. Our Buy rating is supported by our forecast for significant EPS upside stemming from four sources: cyclical tailwinds, organic growth, operating leverage and capital management.

## Quarterly Earnings Estimates

	2023	2024
Q1	0.74A	0.33E
Q2	0.37A	0.45E
Q3	0.45A	0.51E
Q4	0.27A	0.58E

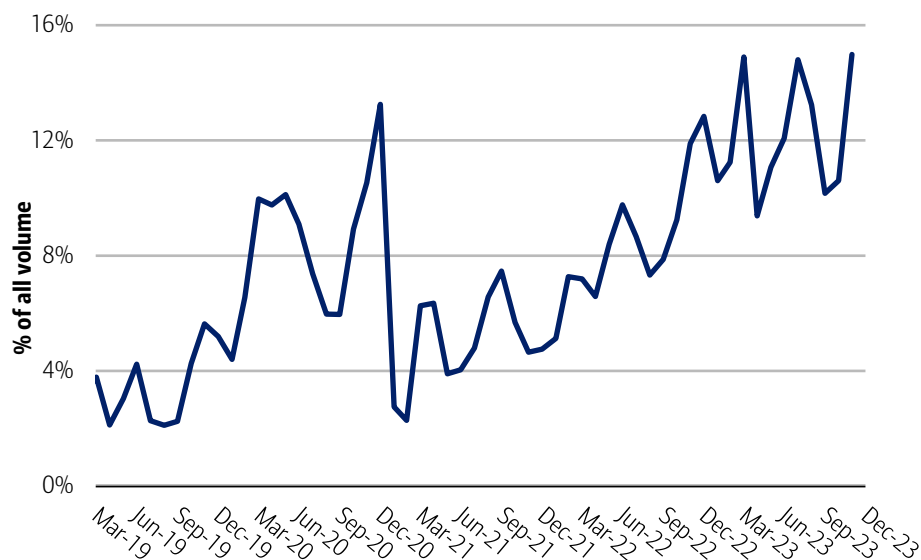
## Additional information

### Laying the groundwork for broader fixed income presence

Although it is still early days, VIRT is laying the groundwork for a larger presence in fixed income. It has already connected to all the major US e-trading platforms and has made several strategic hires. Management noted that it intends to first prioritize growing its cash rates presence before investing in credit given the similarities between cash rates and equities (VIRT's home turf). The rapid electrification of fixed income since the onset of the COVID-19 pandemic has captured the attention of several of the leading electronic market makers. Citadel Securities launched its credit business last year, and Jane Street has grown to be the third-largest credit market maker on MarketAxess. Additionally, management noted that a fixed income entrance has been made more enticing by the prospect of lower capital requirements as a result of both the recent CME/FICC cross margining agreement and the SEC treasury central clearing rule. With that said, management does not expect the business to be a meaningful revenue contributor for at least a couple years.

### Exhibit 1: Sub-dollar shares as a % of total consolidated volume

Sub-dollar trading hit a record in December, hurting VIRT's revenue capture



Source: BofA Global Research

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### Glossary

SEC: Securities and Exchange Commission

CME: CME Group

FICC: Fixed Income Clearing Corporation

ETF: Exchange-traded fund



## Price objective basis & risk

### Virtu Financial (VIRT)

Our \$20 PO is formed using a 5.5x EV-to-EBITDA multiple on our 2026 EBITDA forecast. Over the last 5 years, VIRT has traded at a multiple of 5-10x and its exchange peers currently trade at a rich premium of 15x. Risks to our thesis include: (1) Intensifying competition in equities and strong rivals (including powerhouse Citadel Securities), (2) Continued cyclical pressures from tight monetary conditions, (3) Extreme volatility that dampens opportunities or drives losses, (4) Adverse regulatory outcomes, (5) Lack of scale in options markets and (6) Elevated financial leverage.

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Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
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	Ameriprise Financial	AMP	AMP US	Craig Siegenthaler, CFA
	Ares Management Corp	ARES	ARES US	Craig Siegenthaler, CFA
	BlackRock, Inc.	BLK	BLK US	Craig Siegenthaler, CFA
	Blackstone	BX	BX US	Craig Siegenthaler, CFA
	Blue Owl Capital	OWL	OWL US	Craig Siegenthaler, CFA
	Cboe Global Markets	CBOE	CBOE US	Craig Siegenthaler, CFA
	Interactive Brokers	IBKR	IBKR US	Craig Siegenthaler, CFA
	Intercontinental Exchange	ICE	ICE US	Craig Siegenthaler, CFA
	KKR & Co. Inc.	KKR	KKR US	Craig Siegenthaler, CFA
	Raymond James Financial	RJF	RJF US	Mark McLaughlin, CFA
	TPG Inc	TPG	TPG US	Craig Siegenthaler, CFA
	Tradeweb Markets Inc.	TW	TW US	Craig Siegenthaler, CFA
	Victory Capital Holdings, Inc.	VCTR	VCTR US	Craig Siegenthaler, CFA
	Virtu Financial	VIRT	VIRT US	Craig Siegenthaler, CFA
<b>NEUTRAL</b>				
	Affiliated Managers Group	AMG	AMG US	Craig Siegenthaler, CFA
	Apollo Global Management	APO	APO US	Craig Siegenthaler, CFA
	Brookfield Asset Management	BAM	BAM US	Craig Siegenthaler, CFA
	CME Group Inc	CME	CME US	Craig Siegenthaler, CFA
	Invesco	IVZ	IVZ US	Craig Siegenthaler, CFA
	Janus Henderson Group	JHG	JHG US	Craig Siegenthaler, CFA
	LPL Financial Holdings	LPLA	LPLA US	Craig Siegenthaler, CFA
	Patria	PAX	PAX US	Craig Siegenthaler, CFA
<b>UNDERPERFORM</b>				
	Charles Schwab Corp.	SCHW	SCHW US	Craig Siegenthaler, CFA
	Franklin Resources	BEN	BEN US	Craig Siegenthaler, CFA
	Nasdaq	NDAQ	NDAQ US	Craig Siegenthaler, CFA
	Robinhood Markets	HOOD	HOOD US	Craig Siegenthaler, CFA
	T. Rowe Price	TROW	TROW US	Craig Siegenthaler, CFA
	The Carlyle Group	CG	CG US	Craig Siegenthaler, CFA



## iQmethod<sup>SM</sup> Measures Definitions

### Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

### Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

### Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill Amortization

Shareholders' Equity

Sales

N/A

N/A

### Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

### Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash &amp; Equivalents

EBIT

### Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

### Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

### Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

### Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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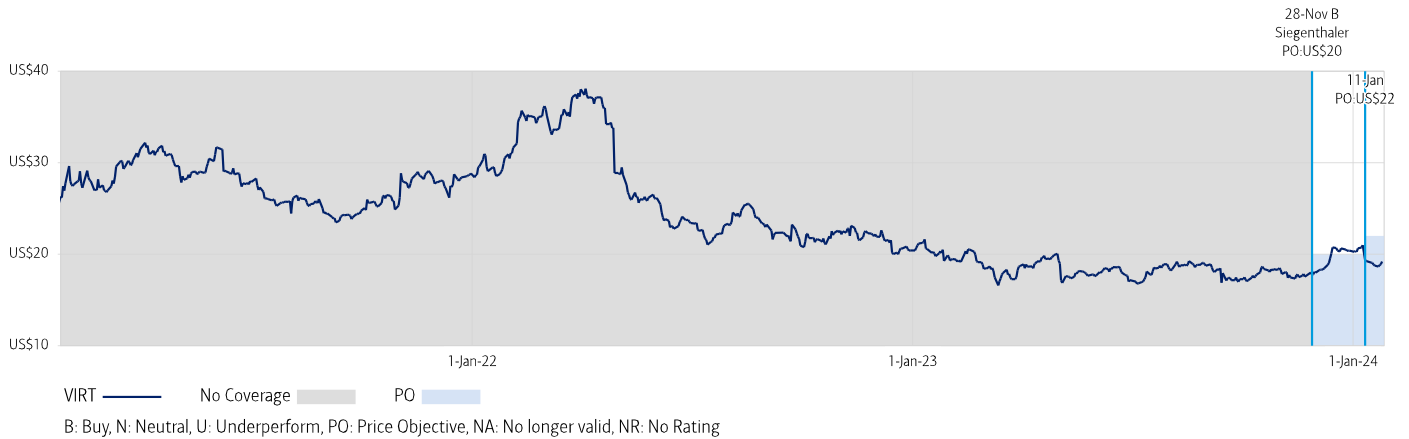
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### Virtu (VIRT) Price Chart



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Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

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