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MSCI Inc. (MSCI) CEO Henry Fernandez on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-31-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $1.68 beats by $0.09 | Revenue of $394.25M (10.15% Y/Y) beats by $5.67M

Earning Call Audio

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MSCI Inc. (NYSE:MSCI) Q3 2019 Earnings Conference Call October 31, 2019 11:00 AM ET

Company Participants

Salli Schwartz - Head of Investor Relations & Treasurer

Henry Fernandez - Chairman & Chief Executive Officer

Baer Pettit - President & Chief Operating Officer

Linda Huber - Chief Financial Officer

Conference Call Participants

Toni Kaplan - Morgan Stanley

Manav Patnaik - Barclays

Hugh Miller - Buckingham

Chris Shutler - William Blair

Bill Warmington - Wells Fargo

Craig Huber - Huber Research Partners

Henry Chien - BMO

Joseph Foresi - Cantor Fitzgerald

Keith Housum - Northcoast Research

Patrick O'Shaughnessy - Raymond James

Operator

Good day, ladies and gentlemen and welcome to the MSCI Third Quarter 2019 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct a question-and-answer session, where we will aim to limit participants to one question and one follow-up. We will have further instructions for you at that time. As a reminder, this conference is being recorded.

I would now like to turn the call over to Salli Schwartz, Head of Investor Relations and Treasurer. You may begin.

Salli Schwartz

Thank you, operator. Good day, and welcome to the MSCI third quarter 2019 earnings conference call. Earlier this morning, we issued a press release announcing our results for the third quarter. This press release, along with our earnings presentation and a brief third quarter update, are available on our website, msci.com under the Investor Relations tab.

Let me remind you that this call contains forward-looking statements. You are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date on which they are made and are governed by the language on the second slide of today's presentation. For a discussion of additional risks and uncertainties, please see the risk factors and forward-looking statements disclaimer in our most recent Form 10-K and in our other SEC filings.

During today's call, in addition to results presented on the basis of U.S. GAAP, we also refer to non-GAAP measures, including but not limited to, organic operating revenue growth rates, adjusted EBITDA, adjusted EBITDA expenses, adjusted EPS and free cash flow.

We believe our non-GAAP measures facilitate meaningful period-to-period comparisons and provide insight into our core operating performance. You'll find a reconciliation to the equivalent GAAP measures in the earnings materials and an explanation of why we deem this information to be meaningful, as well as how management uses these measures on pages 21 to 29 of the earnings presentation. We will also discuss organic run-rate growth figures, which exclude the impact of changes in foreign currency and the impact of any acquisitions or divestitures.

On the call today are Henry Fernandez, our Chairman and CEO; Baer Pettit, our President and COO; and Linda Huber our Chief Financial Officer. I would also like to point out that members of the media may be on the call this morning in a listen-only mode.

With that, let me turn the call over to Henry Fernandez. Henry?

Henry Fernandez

Thank you, Salli. Hello, everyone and thank you for joining us today. Before I start, I would like to say that we're very pleased to have Salli with us on her first earnings call at MSCI. So congratulations to you Salli and we're fortunate to have you.

In the third quarter, we again saw strong performance across our franchise. With over -- with year-over-year growth of 10% in revenue, or 12% on an organic basis, 13% in adjusted EBITDA and 24% in adjusted EPS. In addition to these exceptional financial results, we achieved several significant milestones. We struck new long-term agreements with BlackRock, Intercontinental Exchange, Deutsche Börse and Charles River Development and we acquired Carbon Delta. These agreements aligned as well with key strategic partners and provide us with important capabilities that will continue to enhance our growth and competitive differentiation.

On BlackRock, we extended our successful strategic relationship with them for another 10 years through March of 2030. As you are well aware, there are strong secular drivers of assets into ETFs and this new agreement create a tremendous opportunity for MSCI.

Our renewed contract with BlackRock aims to maximize long-term revenue growth by further balancing and aligning the price volume mix in our arrangement with them. More specifically on the deal, the current licensee rates BlackRock base to MSCI will be reduced for ETFs with total expense ratio below certain levels according to our phased implementation period.

In these ETFs our current fee rates have become a much larger percentage to total fees than originally anticipated. Therefore, the new agreement corrects for that. The aggregate reduction to our total asset-based fee run rate as of September 30 of this year associated with this adjustment is not material. Based on the AUM as of September 30 and based on the most recently confirmed total expense ratios of these ETFs that are subject to recent adjustment.

Any potential future reductions in total expense ratios of licensed BlackRock ETFs may reduce the license fee rates payable to MSCI for those ETFs. These fee reductions are balanced by the potential for incremental assets to flow into licensed BlackRock ETFs.

As you know well, we have seen substantial growth in ETFs over the past decade, with global ETF assets up again thus far in 2019 by approximately 20%. Our continued aim with BlackRock has been to more closely align our mutual opportunities and successes in the ETF marketplace, and this agreement fully reflects that approach by them and by us.

We're very excited about the path we see in front of us, and we believe we're extremely well positioned to benefit from MSCI's ongoing innovation and product development, as well as the underlying trends that support the continued flows into ETFs.

We also recently expanded our strategic relationship with the Intercontinental Exchange or ICE, who as you know is a leading operator of global derivative exchanges and clearing houses and a provider of fixed income data. In addition to extending the existing license agreement for list of futures based on MSCI Indices, we licensed to ICE our ESG data for their fixed income index construction, and we licensed from ICE fixed income pricing and reference data to use across MSCI, including for MSCI fixed income indices.

We singularly just renewed our strategic relationship with Eurex, one of the world's leading derivative exchanges and part of Deutsche Börse Group in Germany. We've not only extended the terms of our license agreement for the existing MSCI index listed futures in Europe, but also expanded the agreement to include futures on MSCI ESG indices to capitalize on the growing interest in sustainable investment. This type of strategic relationships are mutually beneficial. They drive innovation and they deliver increased value for our clients and the industry as a whole.

Similar to our focus on driving value through close strategic relationships with a wide variety of leading industry players, we continue to selectively pursue highly strategic bolt-on acquisitions of companies like Carbon Delta, which enhance our capabilities in key growth areas, generate attractive returns and drive long-term growth and differentiation for MSCI. We're extremely excited by the opportunities that will result across all of these developments.

I will now turn the call over to my partner, Baer Pettit, who will provide more color on our continued progress in those two areas of index derivatives and ESG, including the Carbon Delta acquisition.

Baer Pettit

Thank you, Henry. We spoke about index derivatives on our second quarter earnings call, and I'd like to briefly update you on our ongoing progress. Index derivatives, including futures and options continue to gain traction as the investment community use them as effective tools to implement hedging and other strategies. The extension of our contracts with ICE and Eurex that Henry mentioned will strengthen our footprint in this area of our index franchise.

In the past quarter, we saw asset-based fee revenue or ABF from futures and options more than triple and the notional value created and listed futures and option linked to MSCI indexes reached a record level of $1.5 trillion. Listed futures and options based on our flagship indexes continue to gain traction with open interest in futures and options linked to our emerging market and EAFE indexes together growing 31% year-over-year.

Henry also referenced ES&G, a topic of significant interest not only to the investment community but also to governments, corporations and various other constituencies. We've seen significant growth in interest in MSCI the ES&G ratings research and other products. We continue to enhance our offerings and recently announced the release of ES&G ratings for over 34,000 funds of ETFs in the equity and fixed income universe.

ES&G considerations are relevant not only to traditional asset owners and asset managers, but also to wealth managers, retail investor platforms, hedge funds, broker-dealers and corporations. Within all these institutions, we continue to see demand from a growing variety of user types including CIOs, portfolio managers, risk officers, government teams, compliance teams and ES&G specialists.

ES&G factors also impact a range of asset classes extending from equity to fixed income to private assets like real estate and private equity. One area where we're seeing significant demand for new product capabilities is climate risk as various market constituencies look to understand and evaluate potential climate change.

We intend to be the largest provider of tools for evaluating the impact of climate risk on investment portfolios. To that end, you saw us acquire Carbon Delta, which is a Zurich based environmental fintech and data analytics firm. Together, MSCI and Carbon Delta will offer climate value at-risk and innovative and pioneering climate-risk metric that calculates the impact of client's climate change on a company's market value and helps investors understand and quantify these risks within their portfolios.

MSCI's growing set of climate change offerings together with our research, allows investors to more effectively achieve specific climate objectives including avoiding or diversifying carbon risks, gaining exposure to clean technologies and engaging with companies. We will keep you apprise on our ongoing progress in ES&G, which is very clearly becoming an integral part of portfolio construction.

And with that, I'll turn it over to Linda to take us through the financial highlights and discuss our current guidance for 2019. Linda?

Linda Huber

Thanks Baer, and hello to everyone on the call. MSCI continued it's momentum with an eighth straight quarter of organic subscription run rate growth around 10%. This growth was driven by strength across both our geographic regions and our major client segments.

Looking first at geographic regions. Our organic subscription run rate was up 8% in the Americas, 11% in EMEA, and 13% in Asia. For asset owners and asset managers, which collectively comprise about two-thirds of our subscription run rate, we saw organic subscription run rate growth of 12% and 10%, respectively.

MSCI continues to provide its clients with mission-critical products and superior customer service, leading to healthy mid-90s retention rates across our segments. For recurring net new sales, nine months 2019 was up 8% with the third quarter specifically up 3% while index and ESG saw growth of 12% and 31%. Analytics had lower growth as it left a strong third quarter in 2018.

I'd like to draw your attention to non-recurring sales, which were up 32% year-over-year to $14 million, primarily driven by increased sales in our BarraOne and RiskManager product offerings and in our index derivative product offerings. This was the sixth straight quarter of non-recurring sales greater than $8 million. On a year-to-date basis, total non-recurring sales were up 27% including Analytics up 45% and Index up 26%.

Turning to our performance in ABF, we continue to benefit from our focus on derivatives with listed futures and options, revenue tripling as Baer referenced earlier. We also note that ABF revenue from futures and options was up over 100% year-over-year even excluding approximately $5 million of additional fees associated with prior periods attributed to retrospective price increase from a renegotiated contract.

ETFs ABF revenue was up 5% with a 7% increase in year-over-year average assets under management or AUM and equity ETFs linked to MSCI indexes, partially offset by year-over-year decline in average basis points.

Finally, non-ETF passive funds revenue was up 11%, driven by increased contributions from higher fee products. Equity ETFs AUM linked to MSCI indexes ended the quarter at $815 billion, up 6% versus the prior year. Average fees continue to gradually decline as lower fee products capture a disproportionate share of new flows into equity ETFs.

With regards to geographic market exposure, there were $13 billion of inflows into funds based on U.S. exposure indexes, with more than half in ETFs based on MSCI's Factor indexes, primarily in the low volatility and quality products and about one fifth in ETF space on MSCI ESG Indexes. MSCI's operating revenue continued the pace in the third quarter, with growth across all product segments, as we described in our earnings release published this morning.

Our strong execution in the quarter resulted in high-quality earnings growth, mainly driven by operating momentum. We had no share repurchases during the third quarter, but our earnings continued benefit from the significant share repurchase activity in late 2018. Free cash flow from third quarter was $174 million, up $43 million year-over-year, primarily driven by higher cash collection and lower income tax payments, partially offset by higher payments of cash expenses and higher capital expenditure costs.

Turning to our capital position, our cash balance at the end of the third quarter was $881 million. Our approach to capital allocation remains the same with no changes to, first, our dividend policy of 40% to 50% payout of adjusted EPS; second, our leverage target of three times to 3.5 times total debt to adjusted EBITDA; and third, our approach to mergers partnerships and acquisitions and share repurchases, both of which remain very opportunistic.

I'd like to now provide an update on our guidance for the remainder of the year. As we remain focused on driving growth, we will keep investing in a number of high return opportunities. We continue to expect adjusted EBITDA expenses and CapEx will be towards the high end of our guidance range of $685 million to $705 million for adjusted EBITDA expenses and $45 million to $55 million for CapEx.

With regard to our tax guidance, we are lowering the range of our full year effective tax rate and now expected to be between 6% and 9%. As you're aware, this rate includes an income tax benefit, related to divesting of certain multiyear performance stock units in the first quarter, which has been excluded from adjusted ETFs. Excluding this benefit of approximately 11 percentage points, we now expect the effective tax rate used for our adjusted EPS to be in the range of 17% to 20%. And with regard to free cash flow, we expect to be at/or slightly above the high-end of the guidance range of $545 million to $585 million.

And before we move to Q&A, I'd like to turn the call back over to Henry.

Henry Fernandez

Thank you, Linda. I wanted to highlight a press release, we issued this morning announcing the promotion of Alvise Munari to Global Head of Client Coverage, effective January 2 of next year. As well as the retirement of Laurent Seyer, MSCI's Chief Operating Officer and Chief Client Officer. I would like to reiterate my deepest appreciation and gratitude to Laurent for his leadership and dedication to MSCI and to our clients. Laurent has led the transformation of our global client coverage organization and positioned us well to realize the many growth opportunities we have across our businesses.

We'd also like to congratulate Alvise on his promotion. Alvise spent a great deal of time in the last few years with Laurent visiting clients. I can attest that he will further develop and expand our global client relationships as we continue to focus on powering better investment decisions made by those same clients.

We will now open the line to take your questions.

Question-and-Answer Session

Operator

[Operator Instructions] And our first question comes from the line of Toni Kaplan with Morgan Stanley. Your line is now open.

Toni Kaplan

Thank you. This is probably a five-part question. But want to start with the BlackRock contract extension. So, just assuming expense ratios keep coming down in the industry. Would this sort of enable your fee rates to move more quickly?

Also you mentioned the fees implementation period. How long will that be? You mentioned the first adjustment in March, but how many phases are there? And then the license fee rates MSCI and that will be reduced for certainly steps in March, how much of an impact will this be to the average fee rate at that time?

And then I want to ask about the $5 million if that's related to the $15 million addition to run rate? And just because you're putting it in the asset fee-based run rate, are you expecting that this $15 million recurs over time? I'll leave it at that.

Henry Fernandez

Yes. So, obviously, we will give you some directional comments of what our arrangement with BlackRock is, but we will not be able to comment on very specific given our policy of not commenting on specific matters pertaining one client.

So, it's important to understand the comment under the disclosure that we have made in the following sense. The agreement calls for a series of fees that appears depending on the total expense ratio of each one of these funds.

The adjustment that we mentioned that is phased in over about a 10-month period from March of next year relates to those ETFs that as I mentioned in my remarks had abnormally high percentage of their fee being the MSCI fee. So, that takes care of those things and that adjustment based on current AUM and current dollar expense ratio is relatively immaterial to the asset-based fees.

The second part of obviously what we're trying to do is for the next 10 years prepare the relationship with BlackRock to be totally aligned with market dynamics that to the extent that there are meaningful changes in the total expense ratio of each fund so in this case obviously coming down that our fee then gets to be commensurate to the level of split that we were intended to from the very beginning in many of those funds.

And therefore it appears down depending on the total expense ratio associated with that. And the goal in full alignment with BlackRock is to ensure that they have this flexibility in their own ETFs to trade-off the volume versus price to gain market share and acquire new assets and that MSCI's fees are not in the way of creating a disproportionate amount of our fees to the total expense ratio.

Linda Huber

And Toni, it's Linda. You further asked about the $15 million addition to asset-based fees in the run rate that we spoke about and as you're probably aware we're open to working with a wide range of partners so that we can best help clients achieve their investment objectives.

As we have noted we recently renegotiated a few of our agreements as Henry spoke about. And based on the third quarter 2019 trading volumes, we expect that those will add approximately $15 million to our asset-based fees run rate.

Now, some of these additions is already in the third quarter ABF run rate and the rest will come into quite in the next six months. That is separate from the impact of the amended BlackRock agreement and we are not able to provide more detail on which companies any of that relates to given confidentiality agreement. So, hope that's helpful and that's all that we can say.

Toni Kaplan

Very helpful. And then my second question is very short. Trying to ask about the agreement with ICE I thought it looks really interesting and just wanted to understand sort of long-term where that relationship would go?

Henry Fernandez

We have a great relationship and increasing one with ICE in two areas -- in two major areas a lot of other areas, but in two major areas. One is clearly the listed futures and options part, which we have had for quite some time. So we renewed that agreement and we renewed our commitment to create new indices for them or license existing indices to them, so that they can continue to launch listed futures based on our IP. The second part of the agreement has to do with their fixed income data business, the former IDC or

Interactive Data Corporation business in which they have as you know they have evaluated prices and terms and conditions on an extremely large universe of funds around the world.

So we are going to be licensing from them. That relevant data for us to use across a lot of our products on MSCI including potentially MSCI's fixed income indices. Likewise, they're licensing from us our ESG data is the ratings, is the indicators and all that so that they can incorporate ESG criterias or criteria into the construction of their own fixed income indices. So that they can create ICE branded ESG fixed income indices.

Toni Kaplan

Thanks very much.

Operator

Thank you. And our next question comes from Manav Patnaik with Barclays. Your line is now open.

Manav Patnaik

Thank you. My first question is just around the flows and I think there a lot of numbers out there, so correct me if I'm wrong, but yesterday I think S&P talked about how 70 billion of inflows where there into the non-U.S. size. I think you guys said there was 5 billion of inflows and I believe in the commentary you also said there was positive U.S. inflow. So does that mean non-U.S. was negative or am I just not comparing the right number there?

Linda Huber

Manav, it's Linda. I don't think we want to comment on what other companies have quoted in their earnings release. I think what you have pointed out that's correct. The bulk of inflows was into U.S. funds in the third quarter and a smaller share with -- into emerging market funds. For us, we're stronger in the emerging markets. So the balance was less helpful to us frankly. So can't comment on the other specific numbers, but you certainly have the trends right and just wanted to make sure that you understood the emerging markets fees which has been weaker.

Henry Fernandez

As Linda was talking I was pulling out here the data hard to do that while talking, right. But -- so for the quarter and for the third quarter and related to MSCI-linked ETFs, the total according to our numbers right, total amount of flows into equity ETFs related to MSCI was about $5 billion. And that was made up of increasing flows to U.S. exposure ETFs of about let's say about $13 billion or so slight negative to develop market exposure excluding the U.S. on a $13 billion negative or outflows to emerging markets.

Manav Patnaik

Okay. Got it. And then just a quick follow-up. Congrats on renewing a lot of the contracts that you mentioned. Are there any other notable moving ones coming up that we should be aware of?

Baer Pettit

Nothing on the scale of the ones that we mentioned. I mean clearly, we are in continuous discussions with many of our clients and we don't eventually discuss specific contracts on this call as you're aware. So I think generally we've got a lot of things going on, but nothing that's noteworthy or that stands out.

Henry Fernandez

What I would add Manav is that just to add some strategic commentary is that as you have heard those talk about in the past, we are intensely focused on developing the index licensing franchise over MSCI into derivatives across all forms of derivatives and across the world. So it's obviously that's made-up of listed derivatives, listed in exchanges, futures and options. And therefore, we have a number of partners in the world, the major ones are ICE and Eurex and the Singapore Exchange in Asia. And the second point, we're very focused on over the quarter or structure products derivatives market with broker-dealers and all of those things are significant areas of incremental growth for MSCI, because on the structure product side we haven't been that sort of presence, and on the derivatives side we're getting excited because the market for multi-country and multicurrency index futures is developing fast and we are obviously the largest provider of indices in that space.

Manav Patnaik

Got it. Thank you very much.

Operator

Thank you. And our next question comes from the line of Hugh Miller with Buckingham. Your line is now open.

Hugh Miller

Good morning. Thanks for taking question. Had one on the cost savings given the hiring you made on the head of LEAN practices, I know, it's early days and then it's a hire, but if you could just give us is on kind of the expense savings opportunities that you foresee maybe in 2020? And any key areas that you see as an opportunity to focus on?

Baer Pettit

The way I would characterize that opportunity in that hire is really part of our ongoing business management, which we've discussed on this call over a number of years. So I don't think that, there is any particular area that we view as sort of particularly a target if you like. The one thing, I would say is that, we have been consistent in saying that our one MSCI strategy which brings together a lot of our intellectual property as a benefit to our clients is also an efficiency story.

So as we reduce duplication of different technologies as we consolidate databases as we align standards and technology all of those things will create efficiencies over time. And we're very focused on that day-in day-out in the management of the business. So it's not really a specific category, it's just a culture of efficiency and a culture of removing duplication and creating better standards across the firm.

Henry Fernandez

One other comment that I would make on that is that the – we categorize our EBITDA expenses into expenses that are to run the current business and continue to see the revenues of the current business and expenses that are much more investment type, which are to create new things and to change the business and change the direction of the business. So what we're trying to as we said in the Investor Day what we're focused on is we have enormous opportunities to invest at MSCI on very high-return projects given the nature of what we're doing and the demand for what we have.

So with the investment dollars to achieve that, so what we're constantly doing as Baer indicated is creating high levels of efficiencies in what we do day-to-day to run our existing operations to free up resources, so that we can invest in those new things and continue to have a gradual margin expansion in the business. So, we believe that that is a very strong discipline over MSCI and it helps us grow the revenue line over time and continue to deliver high levels of profitability in the company.

Hugh Miller

Great. Thank you for the detail. Very, very helpful. And then I guess a follow-up question on the tax rate side. I understand that we're not giving guidance for 2020 overall but given the improvement we've seen this year can you just give us a sense of how we should be thinking about the run rate that's realistic for 2020 for the tax rate?

Linda Huber

Yeah. It's Linda. I think we would prefer not to get into that. There's a world of tax changes happening right now and with a lot of discrete items in motion I think we would prefer to wait until we move into the first quarter of next year to give our views on tax guidance for next year. But please rest assured we will do it when we get to our first quarter earnings call.

Hugh Miller

Understood. Thank you.

Operator

Thank you. And our next question comes from the line of Chris Shutler with William Blair. Your line is now open.

Chris Shutler

Hi, guys. Good morning. On the -- back to the BlackRock agreement. So where, I think, your fees go down as BlackRock reduces its expense ratios. How will that differ versus the way that your current agreement is set up? I thought that you currently price as a percentage of the expense ratio may be tiered, but was that not the case?

Henry Fernandez

What the difference is -- is that there were absolute floors associated with all the funds and therefore what you now have is a number of tiered floors in various, sort of, categories of total expense ratios.

Chris Shutler

Okay. So you said more tiers basically that's the way to think about it?

Henry Fernandez

Yes. Yes.

Chris Shutler

Okay.

Henry Fernandez

There was always a percentage of the total expense ratio, but there was an absolute floor in which it didn't matter what the total expense ratio was. Our fees cannot go beyond that -- below that. So now what we've done is create a different -- a number of categories of tiers and each tier has it’s own percentage and its own floor which reflects the fact that the market pricing or total expense ratios on ETF are far broader than 10 years ago. There's a much broader range of products and different price points serving different purposes.

Chris Shutler

For sure makes sense. And then the other question I had was regarding the commentary in the press release around the leverage. Current target 3 times to 3.5 times growth to EBITDA. I think you're in the middle of that range today. It sounds like you're considering taking on more debt. Where would you expect to take leverage target or could you take it? And what would you do with that extra capital?

Linda Huber

Sure. As we had said at the quarter end we had $2.6 billion of debt outstanding, which is 3.2 times our trailing 12-month adjusted EBITDA and our stated gross leverage target to adjusted EBITDA is 3 times to 3.5 times. We do monitor the market and we'll be opportunistic as we think about potential financing. We also note that the Board has added another $750 million to our share repurchase authorization to bring us to $1.456 billion and we're going to think about those things very opportunistically.

Chris Shutler

All right. Thank you.

Operator

Thank you. And our next question comes from the line of Bill Warmington with Wells Fargo. Your line is now open.

Bill Warmington

Good morning, everyone. And hello and welcome to Salli. Question for you on the ETF side. There's been some recently announced highly publicized reductions in retail trading fees. And I just wanted to ask what you saw the impact to that would be on ETF demand and pricing for MSCI?

Henry Fernandez

Well I think anything that reduces the friction for trading of financial instruments creates a lot more ability by investors to invest larger amounts in those instruments because they now have less friction to come in or to come out of them. So that was well for ETFs because ETFs are in a much more trading instruments than mutual funds for example. And therefore we anticipate that it will continue to be more asset coming to ETF over and above what is currently coming.

Bill Warmington

And then for my follow-up question. I wanted to ask about the megatrend in the fees just how -- what are you looking at these days in terms of AUMs tied to those? How quickly early growing? When do you think they'd move the needle?

Baer Pettit

So we're still for sure at the ground floor and that I mean these indexes are pretty much hot off the press -- so we've only just launched them. So I don't want to speculate on the exact category. As you can see many of these newer categories of what I would call position exposure type of indexes whether they're in factors or in ES&G have shown very attractive growth. And people there's for certain the market of people who want to have certain market exposures very precisely through indexes. So we would be delighted if they were to follow some of the precedents of the other specialized indexes we have.

We don't want to speculate around that. So I think we'll just have to keep you apprised on those developments in the quarters going forward, but certainly from just a -- from a client response point of view and the dialogues we've been having is very positive.

Henry Fernandez

What I would add Bill is that, again sort of whether the more strategic emphasis is that the – we're moving into MSCI in addition to the flagship market cap indices, the flagship Factor indices, the flagship ESG indices that are more benchmark related to large portfolios. We are rapidly also moving in the direction of creating more narrow, more thematic exposures based on research that we do that translates into these indices and those could be significant demand by ETF providers, by wealth managers, by structured products, over-the-counter derivatives and the like. And therefore this is a whole new growth area for MSCI over time, in which we're just building the underlying indices that will be the basis of portfolios of every kind in the world.

Bill Warmington

Got it. Thank you very much.

Operator

Thank you. And our next question comes from the line of Craig Huber with Huber Research Partners. Your line is now open.

Craig Huber

Yes, thank you. My first question I guess for Linda. Now you've been there a few months Linda, just curious what your brief observations have been so far. What you think investors might be interested in that you might be working on perhaps trying to make the company even more efficient. And I realize it's a very high bar to say that.

Linda Huber

Thanks Craig. Coming up on six months here and it's been an amazing transition. My colleagues are all very impressive, very smart and we moved fast here, mainly driven by Henry's blistering pace.

But we continue to work on efficiencies as Baer had described, because we want to be very sure that we're able to continue to make investments in what we call our Triple Crown investments, which will be the ones that have short payout periods, high returns and are in our fastest growing businesses, which would be index and ESG and then our other businesses are also performing really, really well.

So incredible focus on where we're going to put our dollars as Henry has indicated this is my primary focus. And I think the program we have to do that is moving very nicely. And as we move into next year, we'll have more to tell you about that, but I think that's the most important thing.

Craig Huber

Then my second question. I guess Henry maybe just update us on the numbers you look at in the U.S. active versus passive. What's the breakdown right now the day you're looking at? And what's your best sense where you think that might be. I know it's tough question to ask I would say in two years out here. Where do you think it, sort of, tops out here if you had to guess?

Henry Fernandez

On a secular -- on a structural basis, clearly passive management continues to grow by leaps and bounds. For a variety of reasons, it creates very easy exposures at a very low cost to an investor. There's a lot of research drawn that clearly those portfolios have performed the majority of active portfolios.

So we continue to see that for sure in on a million way with some cycles, obviously, a lot of passive investing can be deemed sometimes to be momentum investing, because you're chasing the things that are going well. And so I don't have the latest statistics of where we are, but I think that the beta as to where the limit is in the short term of passive is not a good one, because there could be a significant amount of assets in the world that are passive not to a point, in which is the vast majority because then obviously it creates opportunities for passive to be able to create.

So that's a good run rate for us. But bear in mind also that we have -- a lot of our revenues, more than half of our revenues and our clients are active managers, and therefore, we spend a great deal of time helping them create the tools and their portfolios with the tools and portfolios to outperform passive and to run their businesses better, so that they develop competitive advantage in the industry.

Craig Huber

Thank you.

Operator

Thank you. And our next question comes from the line of Henry Chien with BMO. Your line is now open.

Henry Chien

Hey, good morning everyone. I just had a question on ES&G. So I understand that there's a bit of a secular headwind or tailwind to assets with ES&G mandates in U.S. and Europe. Just with the context of there's a lot of other providers that are data providers that are going after ESG, but it seems like MSCI's doing particularly well. I just wondered like what would you characterize like why is the data -- the ES&G data so compelling for investors or managers versus other data sets for MSCI?

Henry Fernandez

So let me first say that because you read all of these reports, all these newspaper articles and all of that how many data providers succeed and how competitive the market is and so on and so forth. It is very misleading. Obviously, data is a completely necessary condition for success.

We have now data, you can't create anything, but on top of that what you need to build is what use this data for end investment process, the mission criticality of, let's say, the materiality of the data, you create a lot of data, but what's material to the investment process and what's material to the impact of a particular company or not.

So, when we consider ourselves is the leading provider of those mission-critical tools and the investment process that are taking a lot of ESG into account, whether it's data per sequential, whether it's research, whether it's ratings, whether it's indices, whether it's risk models or whatever. And there are not too many providers in that space. There are not. We have an incredibly amount of runway to continue to lead in that space and that's where we want to be. So, Baer maybe…

Baer Pettit

Yeah. And just maybe to add on that so, and may be reinforcing the point from both the broader point that Henry made and then the narrower example. The broader point is the topic of ES&G needs to be intelligently incorporated into the overall portfolio construction question, whether it's at the total plan level for an asset owner or within a given fund. And so I think it's the combination of the quality of our research and ratings, but also our ability to address the broader context.

The second thing I would say is, and I'm drawing on my observations about the Carbon Delta acquisition, I was in Tokyo for the task force for climate-related financial disclosure, which the government of Japan sponsored a few weeks ago and there is dramatic change in the way that both governments and corporations are looking at that.

One of the goals of that task force is precisely to look at portfolio impact of climate change, which I was alluding to in my scripted comments earlier. Quite frankly there is no one providing adequate solutions in this area. No one.

And so I'm sure there are others attempting to do so. We believe we are ahead of that and we're able to do so the term that they use is uses climate value at-risk, again, this just plays into all the other expertise that we have an understanding portfolio risk, understanding portfolio construction and the broader context in which investors operate.

So, yes, there are many disparate enclosed data providers, but I think MSCI's both leading there, but we were able to help with investors at the broader context of their asset allocation and portfolio construction. And I think it's in that that we have unique competitive advantages.

Henry Chien

Got it. That helps a lot. Thank you.

Operator

Thank you. And our next question comes from the line of Joseph Foresi with Cantor Fitzgerald. Your line is now open.

Joseph Foresi

Hi. I wondered if you could give us an update on your wealth management product. We haven't talked about that I think yet in the call. And any progress you're making, any quantifiable metrics you could put around that?

Baer Pettit

Yes, just to clarify we have a range of products and services which we sell into the wealth segment. And so of our total sales into that segment, we only have one product that I would say was historically defined for it, which continues to say that the sales of that product I would say are in line with our general growth.

Overall, our growth into the wealth segment has been above average over the last year or two. This quarter it's a little weak because we have a comparable from last year, which was an enormous sale, one of the biggest sales that we had last year into a very large broker-dealer in Asia.

So I would say that we're making steady progress. We'd like to see that that growth is above average and this quarter it's a little below average. So I think we're -- I would say there's no breaking news. We continue to be focused on the segment and we continue to put more resources there.

Joseph Foresi

Got it. And then my follow up. Linda you've been there for a while. What's missing? What are you looking for in the M&A front or what are you working on outside of the efficiency side of things?

Linda Huber

Sure. We continue to look at bolt-on acquisitions. We continue to look in the private asset class base, Henry's talked quite a bit about that. I think we look at database sets which are attractive. That might be useful to us. And we also are looking in the fixed income space to see if there's anything that might be helpful to us there.

This is a very time intensive network. My colleague, Andy Wichman, spent a lot of time focusing on the partnership part of things. You can probably see from what we've announced this quarter. We've worked very hard on these partnerships and they're clearly of great importance to us.

But I'm quite open in terms of potential acquisitions and we'd like to stress we don't need to buy the entirety of companies we're very happy to look at partnerships structures and maybe I'll turn it over to Henry to see if there's anything else he would like to add.

Henry Fernandez

Look, I think we are building MSCI into various areas. So what is a lot of the work that remains here on the product side is private asset classes, fixed income. On the geographic area is Asia. We've done very well in Asia recently. We're putting enormous amount of attention there because of the wealth creation that exists there with big pension funds wealth, sovereign wealth funds and the like.

On the client segment, clearly wealth management was asked before is an area that we need to put a lot more investments in and there's more segments like life insurance for example that we're not very high on and that will correspond with our -- once we get a lot of this fixed income products that we're working on that will be a great place to put a lot of effort because as you know life insurance companies buy a lot of fixed income.

Joseph Foresi

Thank you.

Operator

Thank you. And our next question comes from the line of Keith Housum with Northcoast Research. Your line is now open.

Keith Housum

Good morning, guys. Just a little bit clarification on the non-recurring revenues, specifically in the futures and derivatives indexes section. I notice you guys, obviously talk about the agreements with ICE and Eurex, but the growth in the futures and listed options was it relative to those agreements this quarter or was there a onetime nature that we should be thinking about the growth that you saw this quarter?

Baer Pettit

So the question is -- so fundamentally the ABF category is of a recurring characteristic, right? So, the areas where the onetime is typically the largest are mostly related to Analytics, which has to do with the implementation of our deals and the related services.

And then, in Index, it can be certain sales of specific intellectual property, and occasionally also in the over-the-counter derivatives areas with brokers. We have various catch-up fees, the mechanics of which we won't go into here.

But in essence, those are -- it's not in the listed derivatives area that we typically have onetime fees. That is overwhelmingly, a recurring revenue business.

Linda Huber

And to further expand on that, regarding the other parts of the business, just to add to Baer's comments on, Analytics we talked about lumpiness that we see in sales quarter-to-quarter before.

This quarter that was particularly acute because Analytics had a very tough comparable compared to a strong third quarter last year. As Baer mentioned, we won a significant contract last year with very large Asian securities firm, on our WealthBench offering, so the lapping was very, very difficult.

On the pipeline front though, we see a healthy pipeline. And a relatively moderate cancels. You've seen overall for the firm cancels continue to run -- continue to see that we're running at about 95%, in terms of what were able to do with our subscription revenue. So we feel pretty good about all of that.

Hope that, I was able to answer your question.

Keith Housum

You was, thank you.

Linda Huber

Sure.

Operator

Thank you. And our last question comes from the line of Patrick O'Shaughnessy with Raymond James. Your line is now open. Patrick, your line is now open.

Patrick O'Shaughnessy

I apologize for that. In light of your new agreement with BlackRock, I was curious to what extent you think that the fees or ETF partners have had to pay in the past. I've concluded them from computing those aggressively in prices they might have otherwise?

Henry Fernandez

I don't think so. In the past all of these are -- you noticed in my comments a lot of these initially is, just cleaning up a few things here and there that are not material. More importantly, what these agreement is, to prepare for the next 10 years.

And the market dynamics in those 10 years, I don't think there's any intent at this point to change fees or anything like that. It's just to be ready for that 10-year horizon to compete more aggressively, in the marketplace on the price volume mix so that this ETF by BlackRock continue to acquire a significant amount of assets and a significant amount of market share.

So to achieve that, they need to look at their own expense ratios and management fees. And we as a supplier of the IP or IP to them, we cannot be the majority of that expense in our fees.

We have to then be commensurate in our percentage or proportion of fees regarding their fees, but that hasn't prevented anybody from competing in the marketplace. The agreement that we had before worked really well. We're now sort of setting the stage for the next level of competition in assets and growth.

Patrick O'Shaughnessy

Great. Thanks. And then, I seem to be hear more about direct indexing these days and firms like Charles Schwab are talking about it. Do you look at direct indexing as an opportunity thread, or really a non-event for you guys?

Baer Pettit

Look, I think, that the -- so, may be putting this into context to the earlier question about passive versus active, right? So we use the -- we typically use the term index ourselves and there are both, a range of different strategies which -- some of which are for the total markets some are for factors or ETFs or the megatrends that we mentioned.

Clearly, direct indexing is to -- it shows itself today as a basket of securities. So it's really a basket of securities created for individual. So that is for the moment, that is neither, I would say, an opportunity, nor a threat to us.

And I think the question will be, is that structurally different than any other previous coming together of universe of stocks for an individual. There could be opportunities for us there perhaps in providing overlays in portfolio construction and index methodology. But for the moment, I would say, it's fairly neutral for us.

Patrick O'Shaughnessy

Great. Thank you.

Linda Huber

Before we close, I'd like to make one last just quick housekeeping note for everyone who's looking to model fourth quarter. You might have noticed that it's implied that our expenses might be a bit higher in the fourth quarter than they were in the third quarter. That would be correct. It might be a number that's even around approximately $10 million higher.

We wanted to really stress, this first quarter we're picking up expenses for our Carbon Delta acquisition. We just wanted to make sure that everyone understands that. Also, we continue making very selective investments in our strong businesses and we have had a slight increase in head count, most of that in the emerging markets.

And as we're having a pretty good year, we do look toward compensation to probably be quite reasonable given the strong financial results we've seen this year. So just thinking about expenses for the fourth quarter please note those areas and just please be aware as we had spoken about before we have closed Carbon Delta and we're picking up those expenses in the fourth quarter.

I hope that's helpful to everyone. And I think that about concludes what we have in terms of our remarks.

Operator

Thank you. Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.