FLOW TRADERS

# Q2 2024 Results

Friday, 26th July 2024

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**Operator:** Hello and welcome to the Flow Traders Q2 2024 Results Conference Call. Please note, this conference 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 at the end. This can be done by pressing star one on your telephone keypad. 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 your host, Eric Pan, Head of Investor Relations, to begin today's conference. Thank you.

**Eric Pan:** Good morning, and thank you for joining Flow Trader's first quarter trading update call. As you will no doubt have already seen, we released our trading update first in this morning. I am joined here on the call by Flow Trader CEO, Mike Kuehnel, as well as Global co-Head of Trading, Coen van Sevenhoven, who will run through this results presentation. Afterwards, we will be happy to take any questions 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 trading update we will discuss in this presentation are unaudited.

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

**Mike Kuehnel:** Thank you so much and good morning to everyone.

The second quarter of 2024, so a mixed market trading environment, as the total market ETP value traded was up 12 percent when compared to the same period a year ago, but declined by nine percent quarter-on-quarter. Volatility remained subdued and was down 15 percent when compared to the same period last year and relatively flat quarter over quarter. Our own ETP value traded tracked relatively in line with the market, as it increased by four percent in the quarter compared to the same period last year, but decreased by 15 percent when compared to the last quarter. Value traded across each of our three asset class pillars in the quarter saw corresponding movements that were largely in line with markets.

Crypto saw the largest increase year-on-year, but a decrease compared to the last quarter, given the slowing of funds flows into spot Bitcoin ETF in the US in the second quarter. Total income came in at €76.2 million for the second quarter, a 48 percent increase compared to the same period a year ago. Net Trading income came in at €79.5 million, plus other income of 3.3 million. As a reminder, the other income line item reflects the unrealized gains and losses of our strategic investment portfolio. Despite subdued volatility levels that declined a further 15 percent when compared to the same period a year ago, we were able to generate €21.1 million in EBITDA. This is more than a six-fold increase compared to the second quarter of last year. Net profits for the period amounted to €12.8 million in the period, with a basic EPS of €0.3 cents.

The solid results this quarter serve as further validation of our growth and diversification strategy, as we continued to focus on implementing our strategic growth agenda over the last 12 months amidst the subdued trading environment across most asset classes.

I will now hand it over to Coen, our Global Co-Head of Trading, to review recent ETP market dynamics on the next slide.

**Coen van Sevenhoven:** Thanks, Mike, and good morning everyone.

As shown at the top left-hand side of this slide, ETP market value traded increased by 12 percent in the second quarter compared to the same period a year ago but decreased by nine percent compared to the first quarter. Implied volatility in the quarter, as represented by the VIX, decreased by 15 percent when compared to the same period a year ago, and was roughly flat compared to the last quarter. Total ETP assets under management increased by 13 percent in the first half of 2024 to over 12 trillion, given the strength of the overall market and continued net inflows in ETPs. ETP velocity declined broadly across all regions in the quarter compared to both the last quarter and the same period a year ago. In summary, despite the currently muted market activity, the secular industry trend across the ETP universe continues to be strong.

I will now move on to the dynamics within the fixed-income and crypto markets. As shown on the top left of the slide, trading volumes in the investment grade and high-yield bond markets increased when compared to the same period a year ago, but decreased when compared to the first quarter. Volatility levels were down both on the year-over-year and quarter-on-quarter basis, while credit spreads narrowed by almost 20 percent when compared to the same period a year ago. Trading volume and volatility in digital assets was up significantly compared to the same period a year ago but declined by double digits in the quarter compared to the first quarter. Global crypto ETP market value traded elevated when compared to the same period a year ago but declined by about 30 percent quarter over quarter given the slowing of fund flows into the US spot Bitcoin ETFs in the quarter.

On slide six, we present an overview of some of the key performance indicators for the second quarter, as well as for the first half of '24 on a regional basis. As Mike mentioned earlier, market ETP value traded improved in the second quarter compared to the same period a year ago. However, value traded figures were down quarter-on-quarter given the seasonality in our business. In Europe, we maintained our position as a leading liquidity provider in ETPs in the first half of 2024 amidst a muted market environment, which saw volatility decline by double digits compared to a year ago. Our investment in the digital space over the past seven years, along with our ability to rapidly shift capital to segments of the market, allowed us to capture opportunities in the asset class during this period.

Moving to the Americas, we assisted our partners in the US with a Bitcoin ETF launched in the half as a lead market maker, reflecting our long-term commitment to supporting the continued evaluation of crypto and digital assets. The improved regulatory sentiment and increased institutional adoption of digital assets in the US confirm our long-term investment strategy in the asset class. Lastly, with respect to Asia, we continue to see growing contributions year-over-year from our China operations following the approval of our QFII License and the opening of a Shanghai office back in November 2022. We also received market access in the quarter to begin trading commodity futures in China.

I will now hand it back to Mike for the next slide.

**Mike Kuehnel:** Thank you, Coen. After a few years of rapid expansion, we continue to focus on cost and operational efficiencies while implementing our growth strategy at the same time. As this slide shows, six operating expenses in the first half of this year declined slightly, while our MTI increased by 29 percent year-over-year. We achieved strong margins in the first half of the year, as an upturn in revenues delivered a 40 percent EBITDA margin, compared to 27 percent in the same period a year ago. We ended the quarter with 635 FTEs, down from the 646 FTEs at the end of the fourth quarter. This is in line with our guidance of flat to down for the year, given expected efficiency gains while we continue to bring on board additional talent in growth business areas.

Our guidance on fixed operating expenses remains unchanged, as the firm remains fully focused on operating and cost efficiencies across the business while implementing our growth and diversification strategies. Coming to the next slide, over the past 18 months, the CEO of the company has made a concerted push into new markets, asset classes, and geographies with considerable success. Following the arrival of the newly constituted boards, we have conducted a broad-ranging strategic review. We concluded that we have a significant opportunity to capitalize on this period of development and move the company into its next phase of growth. A critical element of this development will be the expansion of our trading capital base, especially given the significant returns we have generated on trading capital historically.

Following a review of the various options to achieve this, we are implementing a wide-ranging trading capital expansion plan. As the first element of this, we recently secured the €25 million bank term loan, and we are looking at several other ways to increase external financing. We have also concluded that the central pillar of the plan, and the most cost-effective way of increasing our trading capital, is to increase the level of retained earnings in the business. Accordingly, we are suspending regular dividend payments until further notice, a move that will accelerate the expansion of the trading capital base and that the board is confident will generate long-term value for the shareholders. We do believe that the firm's new trading capital expansion plan and the continued expansion of our diversified set of existing and newly emerging trading strategies will deliver significant returns.

This will further strengthen our company's role as a leading global trading firm, providing liquidity and efficiency across a wide range of financial markets. Moving to the next slides, I will discuss market trends and our strategy. On the next slide, you can see that the support of megatrends, which underlines the firm strategy, remains very much intact. These four key megatrends continue to shape our market environment, acting as tailwinds to our business and offer increased opportunities. Crucially, these trends all feed into and reinforce each other, as highlighted before. Especially relevant to our core business is the ever-increasing acceptance of ETPs and growth in passive investing. Total industry ETP AUM is projected to double from today's $12 trillion to $25 trillion by 2030, and underscores the strength and importance of the ecosystem we are a key part of.

Electronification of trading is critical for all of our activities, but in particular, it is within the fixed-income asset class, where this is the key structural trend in corporate credit and emerging market sovereign bonds. Increasing adoption of electronic trading ties into our core technology-enabled competency set. As highlighted in the fixed income white paper we published last year, credit algos, for instance, have comprised almost 50 percent of executed volumes in Euro credit in the last two to three years. Particularly in the sub-1 million ticket sizes. Fixed income ETF AUM is projected to triple from $2 trillion today to $6 trillion by 2030. With the recent regulatory developments regarding digital assets, there's growing institutional interest in this asset class, and total assets invested in cryptocurrencies more than doubled from the second quarter of '23 to around $2.5 trillion today.

With the regulatory approval of the first spot Bitcoin ETFs in the US in January of this year and the approval of spot Ether ETFs, we anticipate growing investor demand for digital assets. This class remains the long-term growth opportunity, with the underlying technology expected to drive significant transformation across global financial markets in the coming years. Lastly, regulation continues to support our business in terms of creating a level playing field from the aspect of execution transparency. We continue to work with regulators around the world to drive the increase in transparency and improve liquidity across all markets and asset classes. Now moving to the last slides and this slide, I outlined the firm's four key strategic pillars to grow, strengthen, and accelerate our business. The first is to optimize our core and grow our trading capital.

This means building an increasingly resilient and efficient business model through dedicated optimization of the firm's trading core, while simultaneously growing the firm's trading capital base. This will accelerate the monetization of all existing and new trading strategies across asset classes and regions. The second is to expand and enhance trading capabilities. As such, we will leverage and build out our proprietary infrastructure, capabilities, and expertise to expand into adjacent products and enhance existing trading strategies. The third is to increase our research capabilities and speed of iteration. We will further adopt emerging technologies to enhance automation and efficiency, increase our reporting and tracking abilities to improve pricing, hedging, and automation, and deploy the global quantitative research framework to improve modelling and trading strategies.

Last but not least, we seek to diversify our business and explore adjacent growth opportunities. As such, we will invest in adjacent business propositions related to connectivity platforms, data, and tokens via dedicated partnerships and explore growth opportunities adjacent to our core. We want to grow our role as a globally leading market maker by driving innovation across financial markets and diversifying existing revenue streams.

I will now hand back the call to Eric.

**Eric Pan:** Great. Thanks, Mike.

This concludes the formal part of our presentation. We would now like to open up the floor for any questions you may have. Operator?

## Questions and Answers

**Operator:** Thank you very much. We are now opening the floor for a question-and-answer session. If you'd like to ask a question, please press star one. Again, that's star one. We will pause for a brief moment to wait for the questions to come in.

We have our first question coming from Reg Watson from ING. Your line is now open.

**Reg Watson (ING):** Good morning. Good morning Mike. Apologies for quoting your words back to you. In your statement today, you said that you've concluded that the central pillar of your capital management plan and the most cost-effective means of increasing trading capital is to increase the level of retained earnings in the business. When I look at the balance sheet, retained earnings since 2020 have risen by eight percent, but trading capital has declined by 24 percent. Despite an increase in retained earnings, trading capital continues to decline, and

I would like to understand the mechanics behind that and why you feel that suspending the dividend will change that particular dynamic.

**Mike Kuehnel:** Yes. Thank you so much, Reg, for the question. As part of our internal exercise, we very much looked into the accumulated dividends paid since the IPO and you might have seen that number in our PowerPoints relating to 746 million in dividends paid since the IPO. This relates then to the trading opportunities we see emerging and very much different now with the meaningfully broader set of global reach and asset class coverage. We feel that there is a distinct opportunity to really bring in more capital and also attract external capital. This has been indicated by the 25 million bank term loan we now initially put onto our balance sheet in order to drive our profits. I see the gist here for us very much is that there is an opportunity cost embedded in our business. This relates both to structurally building our trading strategies, but this also relates to market anomalies occurring around us, where an ability to deploy more capital clearly will drive PnL.

**Reg Watson:** Okay. That's clear. Thank you, and then obviously the 25 million bank loan is just a start. Where do you see your capacity to increase that? Where's the upper limit of what you're comfortable with and what your lenders are comfortable with in terms of how much debt you can take onto the balance sheet?

**Mike Kuehnel:** Yes, I'm glad that you asked that question because clearly you want to be and remain highly conservative on this. As it stands now, the 25 million is indeed just the starting point. There's the intent to look into either upsizing this tranche or tapping into alternative sources of financing. I think a good reference to give you a more tangible perspective on what we mean by being conservative is the amount of our trading capital. We would like to be quite cautious in upsizing it, while at the same time bringing back the clear proof points that the incremental capital being retained in the company delivers attractive trading capital returns. I'm quite mindful that we relate it over the last years to our trading capital return. Even since the IPO has been strong close to 80 percent, we intend to scale up the incremental capital coming from the outside so that we are able to demonstrate a healthy return on trading capital nonetheless.

Then coming back to the trading capital as a reference rate. If you take a reference from the US TLB market, just as an example, where it's prudent to level your balance sheet up to half of our trading capital, I think that's a more or less a good indication. However, I think the more relevant point in my mind is that we want to collect the data points needed so that you understand that the increased leverage has an immediate impact on our profitability over the years to come.

**Reg Watson:** Okay. Thanks, Mike, and I'm glad you mentioned that you're taking it cautiously and that you're requiring proof points internally. Obviously, I don't expect you to show them, but it would be useful for us externally. Both analysts and your shareholders would like to understand what proof points you will be disclosing to us to show that this strategy is actually delivering. I know in some quarters, there was a lot of disappointment that you dropped the market share metric, so what do you plan to propose? Also, what do you plan to replace that with?

**Mike Kuehnel:** Yes. I think one key message is that we listened and understood the perspective on increasing transparency. There is a clear point that the return on trading capital for us is the key metric to look at. As I said, if the strategy deployed now gives us the opportunity to attract more capital and to make a point that it will be impactful for our return on trading capital and with outsized returns, that's clearly the intent. The fact that we are bringing back the regional breakdown is a recognition of the level of transparency you need. The internal discussion still centers around how can we add more insight without revealing competitive intelligence around our trading activities. Also, as discussed before, this is a continued process on our side, and we'll make sure that there's increased attention to the trading capital return pattern across the firm.

**Reg Watson:** Okay. Thank you. What do you think a reasonable through-the-cycle return on trading capital is?

**Mike Kuehnel:** For us, it's hard to predict the future as stated before, but I'm quite confident. Looking back on the last five years or even since the IPO, seeing that we have at the bare minimum demonstrated returns of slightly above 50 percent. Then with spiking movements, which are part of our business returns of well above 80 percent, so I feel quite comfortable saying that this is a region we feel comfortable about with even more capital coming to our firm. Let me take one step back. The reason why I'm saying that is that A, we have meaningfully increased our scope, and sometimes I relate to it as the radar screen, so we see a significantly higher number of opportunities around us. Now, with the broadened infrastructure, we are able to act upon it.

I did mention in the past, if you remember, our ability also to shift capital left and right to these opportunities in order to benefit from them. This gives me a deep confidence. Secondly, I also look at the very talented trading leadership team and trading team in order to be able to be in these moments, able to act. This brings me then back to the opportunity cost. With more capital, we will also just by default be able to capture more for arising or in arising opportunities where at least until today, there was a natural, just relatively spoken, limit on how far we could go. That does not imply any change in our risk management or risk appetite, but it really relates to opportunity with more capital. By the way, this should be an exponential curve as there's a compounding effect in capital being retained in the firm and leading to trading opportunities. It gives us a significant chance [inaudible 00:20:58-00:20:59] to quite creatively.

**Reg Watson:** Mike, on previous calls, you've highlighted the fact that you've lost a share in some of your core markets because of more trading capital being deployed by your key competitors in these areas. That is necessarily driven down returns on shares. If you're also increasing your trading capital, doesn't this just lead to a war of capital and simply a diminution of returns?

**Mike Kuehnel:** Yes. I'm glad that you highlighted this, but if I take really a step back and look at the differences in trading capabilities, I think it's fair to say that we have very distinct trading capability sets. They are very much able to embrace fragmentation, very much able to benefit from market circumstances that are hard to model from a prediction point of view, and then have more trading capital. I feel we can act in a protected set of markets with attractive returns nonetheless. I do strategically want to add the decision to now also dive into a multifaceted capital plan as the gist of what matters for us. It's not about the 25 million or any kind of debt capital increase intentions for the next 18 months. What we feel is this is a significant milestone for the firm to really transform the company over the next three to five years into a powerhouse related to the core capabilities we developed.

**Reg Watson:** Okay. Thank you. I appreciate your answers. Thank you.

**Operator:** Our next question comes from Julian Dobrovolschi from ABN AMRO. Your line is now open.

**Julian Dobrovolschi (ING):** Hello. Good morning gentlemen. Once again, thanks for the presentation. I have a couple of questions about a couple of topics. That may be the first one. Also, the follow-up on the trading capital upsides of 25 million. A really quick one, do you already see any clear... Are you thinking in terms of clear pockets of growth that can throw this additional capital, and maybe areas where you feel you are currently underrepresented? I just want to kind of couple this question with the fact that market shares in EMEA dropped in the ETP business to 25 percent. It was about 27 percent at the end of Q4 2023, and obviously 30 percent and above even before that. I believe in the past, you highlighted the fact that the reason that that's happening is just because you're facing higher competition on pricing, and you have in a way enough capital to play all the strategies. Now, with this 25 million upsizing, even though I appreciate it, not too much, should we expect a bit of a recovery in the market share EMEA as well?

**Coen van Sevenhoven:** Hi, Julian. It's Coen. I'll take this question. Correct. As Mike alluded to earlier, being constrained in capital means that we have to pick where we deploy it at any given point in time. By definition, having more capital allows you to be active in more areas at the same time. As part of our global diversification, we're [inaudible 00:24:18-00:24:19] world region asset classes, of course. Having more capital will just allow us to a buyer pool, resources, and attention to do more areas at the same time, and Europe of course being a key area for us. This will definitely help us to maintain our leading position in Europe. The more capital, the better for us.

**Julian Dobrovolschi:** At what cost can you deploy this 25 million? Is it literally at zero cost, so we can basically assume all the NTI that they generate would drop through immediately to the net profit line excluding the interest for it, obviously?

**Coen van Sevenhoven:** Sorry. Can you repeat the question?

**Julian Dobrovolschi:** What is the cost of the additional 20 million of trading capital that the... let's say, the debt portion that it took from the issuers?

**Mike Kuehnel:** It's fair to say it's slightly below 10 percent. If I compare that to the earlier expected return on trading capital, you see that the economic stance is highly accretive. Then the upscaling and looking into alternative sources of debt, either in the TLB market or the private credit facility market. I think it's fair to say that the funding is in a broad range between, let's say, around 12 percent plus-minus, and clearly, as I shared with you before, Julian, we are quite dedicated to really bringing this across. This is a multi-year plan related to the idea to and the intent to create a bit of a benchmark effect so that all the time is being able to deploy more capital and bring in more capital. Therefore, our interest rate on these debt facilities will decrease over time, which is good news for shareholders, clearly.

**Julian Dobrovolschi:** I appreciate the answers. Thanks, Mike. I'm also trying to kind of connect the discussion more on the fact that obviously maybe not now, but the more you grow the trading capital. I believe you also alluded to numbers like let's say 1 billion and even higher than that. Obviously, one cost element would be the interest on this, let's say, debt portion.

The other cost, in my view, would be the fact that you just have to scale up the trading capabilities, maybe even the Infra, but definitely the number of traders. Did you run a bit of a sensitivity exercise on the run rate figure, where would you land in terms of EBITDA margins if trading capital would go all the way to, let's say, 1 trillion?

**Coen van Sevenhoven:** Hi, Julian. Maybe I can answer the first part of this question. Obviously, as we are companies that are trading ETPs, we are already connected broadly across the globe to different regions and asset classes to trade ETPs. For us to deploy new strategies, this will go incremental. It's not that we need enormous investments in order to try to deploy new strategies or try to develop them, so I think that's a big benefit of the state of our business. I think as we expand our capital and some expenses in our cost base, these will only happen if the NTI follows. It won't be necessary to make large investments in our base before we can see results in NTI. In that sense, I think this is a very low-risk, high-reward path that we're embarking upon.

**Julian Dobrovolschi:** Okay. Then on the competition. I think you kind of just discussed briefly the fact that obviously there is a potential of running into diminishing returns, given the fact that everybody's fighting for more trading capital. Now that you're moving from, let's say, core ETP trading into a kind of proper multi-asset market-making a firm run a couple of strategies across different asset classes and obviously across many regions. I'm just wondering, how do you look now at the competitive environment? I just want to leave it a bit of a loose question. I'm just curious how you look at that.

**Coen van Sevenhoven:** Well, I think as you alluded to, our competitors, some of them have larger capital bases, so I think if anything this is also creating a more level playing field. I only see this as a positive element. Other than that, it's hard to comment on the activities of our competition. If I look at our internal roadmap, the boost, and the trading capital we have now... This morning, walking across the floor, feel the excitement and positivity of the whole trading floor with this announcement of the increased trading capital. I'm very, very confident that we're on a strong growth path here.

**Julian Dobrovolschi:** It looks like there are some desks that are the first capital, so there's good news and maybe a final one. It's something that I noticed a couple of quarters ago, but I kind of missed asking this. I did notice that you've changed the vesting of the remuneration pool from four years in the past three years. Why and what kind of effects this might have on the attrition of staff?

**Mike Kuehnel:** Yes. That's an important point. We are constantly reviewing the attractiveness of our broader comp packages. Clearly we are not ignorant of the global dynamics we see also from competition. This was one piece embedded in making sure that we remain competitive. I should say this was not an isolated effort. We, as I said, are constantly reviewing these elements, but it was important for us to make sure that this increased competition, specifically in core parts of the global industry, New York, as a highlight. We found effective ways to remain competitive. Then in terms of iteration, I only can echo what Coen highlighted. Today is, for us as a firm, a significant milestone.

We come out of a very in-depth review of where we stand as a firm and how we see the different growth opportunities emerging. Today is the day marking a significant point in being perceived as a growth stock. Embracing these opportunities with more capital, that's truly exciting. I can see that inspiring many of our staff to become part of it. It's a more qualitative piece that we are mindful of competition, but also feel that there are very specific elements to our strategy and our culture that we are proud of and these elements helping us to drive our growth.

**Julian Dobrovolschi:** All right. Thanks. I appreciate the answers and obviously enjoy the summer holiday.

**Mike Kuehnel:** Same for you, Julian. Thank you.

**Operator:** Hello everyone. Again, if you'd like to ask a question, please press star one. Again, that's star one. We will pause for 10 seconds to wait for the questions to come in.

As of right now, we don't have any raised hands. I'd now like to hand back over to the management for the final remarks.

**Eric Pan:** Great. Thank you Operator. We would like to thank all the analysts for participating in today's call. Please note that we will host our next analyst call when we release our third-quarter trading update in October. Details and timing for this call will follow in due course.

This now ends the call. Thanks again. Have a great day.

**Operator:** Thank you everyone for attending today's conference call. You may now disconnect. Have a wonderful day.

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