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NDAQ - Q2 2017 Nasdaq Inc Earnings Call

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OVERVIEW:

Co. reported 2Q17 net revenues of $602m and non-GAAP net income attributable to Co. of $172m or $1.02 per diluted share.

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PRESENTATION

Operator

Good day, ladies and gentlemen. Welcome to the Nasdaq Second Quarter 2017 Results Conference Call. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to turn the conference over to Ed Ditmire, Vice President, Investor Relations. Sir, you may begin.

Edward Ditmire - *Nasdaq, Inc. - VP of IR*

Good morning, everyone, and thank you for joining us today to discuss Nasdaq's second quarter 2017 financial results. On the line are Adena Friedman, our CEO; Michael Ptasznik, our CFO; Ed Knight, our General Counsel; and other members of the management team. After prepared remarks, we'll open up to Q&A.

Press release and presentation are on our website. We intend to use the website as a means of disclosing material, nonpublic information and complying with disclosure obligations under SEC Regulation FD.

I'd like to remind you that certain statements in this presentation and during Q&A may relate to future events and expectations and, as such, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Actual results may differ materially from these projections. Information concerning factors that could cause actual results to differ from forward-looking statements is contained in our press release and periodic reports filed with the SEC.

I now will turn the call over to Adena.

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Thank you, Ed. Good morning, and thank you for joining us this morning. I am pleased to have the opportunity today to report our strong second quarter 2017 results, update you on our progress regarding our 2017 execution priorities and discuss our long-term strategic initiatives and, importantly, how we are progressing with them.

The company's second quarter results were strong, particularly in our non-GAAP diluted EPS growth of 12% year-over-year. Additionally, we set new quarterly records, including total net revenues of $602 million and non-GAAP operating income of $287 million, up 8% and 11%, respectively, year-over-year. We achieve those despite a lackluster backdrop in terms of the beta for the capital markets industry with respect to its volatility and trading volume. The average daily VIX in the second quarter was near all-time lows and about 25% below the prior year period. That said, when I look closely at the quarter and, more broadly, at the company's progression during my first 6 months as CEO, I continue to be encouraged by the consistently high level of execution I see from our team as well as the enormous potential and possibilities for this firm.

During those first 6 months of 2017, we achieved record revenues, up 8% year-over-year, while our margin expansion drove non-GAAP operating and pretax income up 10%, also setting new highs. Organic revenue growth in the first half of the year has been 4% across our non-trading businesses, led by 10% in Market Technology, 4% in Information Services and 1% in Corporate Services, while our Market Services segment is improving after industry volume headwinds starting the year off with a negative 1Q growth. The balance in our business allows us to grow in a wide variety of underlying macroeconomic and business circumstances. Our results were achieved from a combination of our relentless focus on our clients and shareholders, our confident commitment to hold a long-term view of the opportunities we see on the horizon and our strong conviction in our ability to realize them.

With respect to the second quarter of 2017, in particular, I'd like to review some highlights. On the revenue side, our Information Services business delivered record revenues of $144 million with 7% organic growth, particularly driven by our index business, though growth in proprietary data revenues were also solid.

While Market Technology grew 4% organically in Q2, we think it is especially important to view its progress in terms of the annual cycle. And to this point, our year-to-date growth has been 10%, and we continue to execute on significant opportunities that we believe will continue to deliver material growth in the coming periods.

Market Services achieved positive organic growth of 2%, despite the lackluster volume environment, due to strong market share performance across its largest trading categories, along with continued positive organic growth in trade management services. As with the last quarter, across our largest equity derivatives and equity -- cash equity marketplaces, we're very pleased with our performance in the areas under our control, notably market share, pricing and the implementation of performance and functional enhancements.

Corporate Services saw revenues increased 1%, but produced a 10% increase in operating income as margins expanded meaningfully in the Corporate Solutions business.

Looking at our broader profitability, we realized significant benefits during the quarter from the disciplined approach to operating efficiency that you have come to expect from this firm. Our 48% non-GAAP operating income margin in the second quarter of 2017 was at multiyear highs.

I want to provide you with an update on the key execution priorities that we outlined for 2017, which were -- which are completing the acquisitions -- I'm sorry, the integrations of our acquisitions, increasingly commercializing our expertise in key disruptive technologies and improving our competitive position across all of our businesses.

In terms of the work we're doing to complete the integration of our 2016 acquisitions, we have completed the transition of Chi-X Canada, and we are well underway with the ISE transition to the Nasdaq technology platform. We completed one market earlier in the spring. We are mid-rollout of the largest ISE market now, and we will complete the third in the fall. We have already reached our original cost synergy targets, 12 months after the closing of the last of the 4 acquisitions completed in 2016, which is a full 6 months ahead of the 18-month target that we set originally, and we've identified additional synergies that Michael will detail later.

The next priority we outlined at the beginning of the year is focused on putting in innovative solutions in our clients' hands through the commercialization of disruptive technologies, where we've invested and partnered to develop special areas of expertise. To that end, we continue to be encouraged with the progress of the Nasdaq Financial Framework, our next-generation Market Tech platform that is fully cloud and blockchain-enabled. Building on the NFF sales we announced last quarter, this quarter, we signed agreements with: AIFC Exchange, which is Kazakhstan's newest stock exchange; Deposito Central de Valores, the Chilean CSD; and an agreement with the SIX Swiss Exchange to implement a distributive ledger technology based on -- sorry, distributed ledger technology-based solution for SIX's structured products business.

We also launched the Nasdaq Analytics Hub in the second quarter, which has a number of robust proprietary and third-party data sets as well as analytics layer leveraging machine intelligence. This product expands how we serve the buy side in their investment decision-making process and has generated significant interest since its announcement earlier this year. Our initial launch has generated widespread interest and has led to 20 firms formally trying -- trialing the product so far. The feedback from the trial users has been encouraging, and in the second half of 2017, we have opportunities to turn these users into subscription-paying customers as well as expand the product to include new data sets and functionality, further expanding its appeal. As we have said before, this is a long-term growth opportunity for us, and we are just at the beginning of the journey.

Yesterday's announcements of the Sybenetix acquisition, a small London-based technology company, is another good example of how we're applying disruptive technologies, in this case, machine learning, to benefit our client. This company has pioneered a behavioral science-based approach, incorporating machine learning, which it -- originally applied to serve the buy-side surveillance needs and which will further our buy-side initiatives, but we will also plan to incorporate it into the SMARTS regulatory exchange and sell-side offerings as well.

Lastly, in terms of our 2017 execution priorities is our goal to improve our competitive position across all of our businesses. In Market Services, we're focused on sequential progress, so I'll compare the first half of 2017 to the preceding 6-month period or the second half of 2016. In our 3 largest trading areas, we improved U.S. options share to 42% from 39%, U.S. equities to 18% from 17% and European equities to 65% from 63%. I attribute these gains quite simply to our effective engagement with our clients and, as a result, of finding new opportunities to bring our broad array of marketplace solutions to bear to solve their most important challenges.

Along those lines, we've decided to unify management of all of our Market Services businesses under Tom Wittman, our Executive Vice President of Global Market Services, as a reflection of the way many of our customers are bringing their electronic trading across multiple asset classes into a more holistic management and organizational structure. We want to thank John Shay, who managed our Fixed businesses previously, for his work over the recent periods in helping to bring that business enhance client focus and energy, and we wish him very well as he moves on to new endeavors.

Another area of strong progress has been in our Index business. AUM and licensed exchange-traded products tracking NASDAQ indices reached $147 billion at the end of June, up 36% year-over-year, far outpacing the market gains of 19% for the NASDAQ Composite or 10% for the S&P 500. One of the most interesting drivers of how we've outperformed is that we've added $7 billion in AUM from new products introduced over the last 3 years. Therefore, our innovation and deep relationships with our key to ETF sponsor partners have enhanced our growth potential and our Index business, and we're very proud of our progress. To this point, in this quarter, we are pleased to partner with First Trust on the launch of a new suite of ETFs called Nasdaq Riskalyze and with VictoryShares, which launched its first ETF tracking to Nasdaq Multi-Factor Minimum Volatility Index.

In addition to the very clear ways our Market Services and Index businesses have made share advances, the competitive position of our Market Technology business continues to advance. The investments we continue to make to upgrade our offering with the next-generation capabilities of the Nasdaq Financial Framework are moving the needle in terms of what is required to compete and have materially improved our already-strong competitive position. Clients that can benefit from next-generation capabilities, such as blockchain and cloud, have become exceptional candidates for the Nasdaq offering.

As I pointed to in my opening remarks, there's nothing more important to me and this management team right now than satisfying our client needs and ensuring that we identify and execute on opportunities to drive organic growth across this firm. I believe the recipe for the success in this endeavor will always center on our people and our culture. And to this end, I'm focused on making sure we continue to develop a world-class collaborative team that enables Nasdaq to innovate effectively and execute on growth opportunities and the competitive challenges we face.

Our R&D program, which we've communicated as totaling $40 million to $50 million of annual investments spend, encompasses several initiatives that we believe will create long-term client and shareholder value. Over recent quarters, we've communicated our plans and progress to you across these important growth initiatives, including NFX, our U.S. futures exchange, where we -- where our open interest now stands at over 3 million contracts and volumes and participate continue to be developing well; NPM Alt, our liquidity solution for alternative asset management, which we announced in April; Analytics Hub, which we launched in May and have discussed in the call today; and several SMARTS surveillance growth initiatives. The Nasdaq Financial Framework is being funded through our core Market Tech and Market Services businesses as a more foundational investment to drive those businesses and our entire business forward. We also launched our Ventures program earlier this year, and we have one new investment so far. More broadly, our new initiatives have given us an opportunity to engage more with our clients and then concentrate our investments and resources to focus on the opportunities that can best help us grow over the long term.

We also continue to adapt and respond to the evolving regulatory and geopolitical backdrop, working closely with regulators. We are on a mission to ensure that the regulatory framework in the U.S. supports much-needed reform to increase the appeal of the public market and benefit innovative and growing companies that will lead our economy forward. In May, we released a blueprint for revitalizing the U.S. capital markets, including recommendations we see as essential for the U.S. to retain its preeminence in the global capital market. This blueprint encapsulates Nasdaq's view for the public companies' critical and invaluable role in the capital market's ecosystem and our desire to leverage our unique position as the exchange that is invested to deliver the most comprehensive set of solutions to corporate issuers to advocate on their behalf and, in doing so, support entrepreneurs, innovation and job growth in all of their positive forms for our economy.

To close my commentary, I feel that this year, so far, is demonstrating the balance and resiliency of our model in being able to achieve meaningful progress and growth despite a volume environment that remains challenging. The profitability this delivers allows us to continue to invest in our future through our growth initiatives as well as deliver strong capital returns to our shareholders.

Now I'll turn it over to Michael to review the financial detail.

Michael Steven Ptasznik - *Nasdaq, Inc. - Executive VP of Corporate Strategy & CFO*

Thank you, Adena, and good morning, everyone. My commentary will primarily focus on our non-GAAP results. Reconciliations of U.S. GAAP to non-GAAP results can be found in the attachments to our press release and in the presentation that's available on our website at ir.nasdaq.com.

I will start by reviewing second quarter revenue performance relative to the prior year quarter, as shown on Page 3 of the presentation and organic growth on Pages 4 and 14. The 8% or $43 million increase in reported record net revenue of $602 million consisted of $34 million in net revenues from our 2016 acquisitions of ISE and Boardvantage and organic growth of $15 million with 3% organic growth in the non-trading segments and 2% growth in Market Services. This is partially offset by a $6 million unfavorable impact from changes in foreign exchange rates.

I will now review highlights within each of our reporting segments, and all comparisons will be to the prior year period, unless otherwise noted. I will start with Information Services, which, as reflected on Pages 5 and 14, saw a $10 million or 7% increase in revenue, consisting of $9 million or 7% organic growth as well as a $2 million increase related to the ISE acquisition.

Market Technology revenue, as shown on Pages 6 and 14, increased $3 million or 4% with organic growth primarily driving the change. As Adena noted, organic growth totaled 10% for the first half of 2017 as organic growth in Market Technology tends to fluctuate quarter-to-quarter more than other segments. The growth was driven by increased revenues from: software; licensing and support; Software-as-a-Service, particularly SMARTS surveillance subscriptions; as well as higher change request revenues. New order intake was $64 million in the second quarter, and the period-end backlog finished at $799 million, a record high and an increase of 4% from June 2016. The operating margin for Market Technology was 22%, down 3% from 25% in the prior year period, reflecting the investments we have made to upgrade our technology for the next-generation Nasdaq Financial Framework and enhance and grow our surveillance offering.

Turning to Corporate Services on Pages 7 and 14. Revenues increased $2 million or 1% due to the inclusion of revenue from the Boardvantage acquisition. While Listings activity in the Nordic region is robust and related revenue increased as compared to the year-ago period, revenue growth in the Nordics was offset by lower U.S. Listings revenues from the runoff of listing of additional share fees and an unfavorable impact of future changes and foreign exchange rates. Reflecting the progress we've achieved in our synergy targets, the Corporate Services operating margin was 27% versus 25% in the prior year period.

Market Services net revenues, on Pages 8 and 14, saw a $28 million or 14% increase, reflecting the inclusion of $27 million of revenue from the acquisition of ISE and $3 million of organic growth, partially offset by a $2 million adverse impact from the changes in foreign exchange. Market Services operating income increased 1 percentage point to 55% versus 54% in the prior year period.

Turning to Pages 9 and 14 to review expenses. Non-GAAP operating expenses increased by $15 million. This increase reflects a $9 million or 3% organic increase and a $26 million impact from our acquisitions, partially offset by $15 million in synergies and a $5 million favorable impact from changes in foreign exchange.

Synergies achievement from our 2016 acquisitions rose to $60 million on a run-rate basis in the second quarter, hitting our original target within 12 months of the closing of the last deal, 6 months ahead of the original schedule. We've also identified $10 million to $20 million in additional synergies, which will be realized as we complete various platform transitions. But rather than update you on this specifically going forward, this progress will be reflected in our overall operating expense and profitability measures.

Now turning to Slide 10. Our revised 2017 non-GAAP operating expense guidance is a reduced range of $1.26 billion to $1.29 billion. The updated guidance does reflect our higher planned investment spending in the second half of the year as well as current exchange rates and the adverse $10 million to $15 million estimated impact of the depreciation of the U.S. dollar against both the Swedish kronor and euro. So another way to view this is the reduction would have been larger if the foreign exchange rates have been unchanged.

Non-GAAP operating income increased 11% in the second quarter of 2017, and the non-GAAP operating margin totaled 48%, an increase from 46% in the prior year period. Net interest expense was $34 million in the second quarter of 2017, an increase of $3 million versus the prior year period, reflecting the additional interest expense from the financing of our 2016 acquisitions, but also reflecting $1 million of the partial quarter impact of the late May balance sheet restructuring that we did, which I'll review in more detail in just a minute.

The non-GAAP effective tax rate for the second quarter of 2017 was 33%, at the low end of the 33% to 35% range we provided during the last quarterly call, and there is no material benefit from the adoption of accounting standard ASU 2016-09, which added $0.13 to our Q1 results. We continue to expect the 2017 non-GAAP effective tax rate to be in the range of 30% to 32%, and for the third quarter 2017, we expect the tax rate to also be between 30% and 32% with the fourth quarter expected to be between 33% and 35%.

Non-GAAP net income attributable to Nasdaq for the second quarter of 2017 was $172 million or $1.02 per diluted share compared to $153 million or $0.91 per diluted share in the prior year period. There was negligible impact from the change in tax accounting during the period.

Turning to capital. As we indicated last quarter, we redeemed the 5.25% January 2018 bond with a face value of $370 million using a combination of cash on hand and proceeds from the sale of commercial paper issued through Nasdaq's newly established commercial paper program. Additionally, we utilized our CP program to make a $300 million repayment on our term loan.

During the second quarter, our outstanding debt decreased versus March 31, 2017, due to our refinancing activity with $160 million of net debt repayment, partially offset by a $91 million increase due to FX from a stronger euro, impacting the value of our euro-denominated debt. This resulted in our debt-to-EBITDA ratio ending the period at 3x, unchanged compared to the first quarter of 2017. We continue to expect to delever to the mid-2s leverage level by mid-2018.

We didn't execute any share repurchases in the second quarter. However, as a reminder, we executed $156 million in buybacks during the first quarter. And together with dividend payments, including the 19% increase we announced last quarter, we have returned $272 million to shareholders in the first half of the year. This is double the $139 million returned in the first half of 2016 and represents 76% of our non-GAAP net income for the first half of the year.

Looking forward, in respect to our capital deployment and return priorities, while, in the near term, our actions, in part, will reflect our commitment to deleverage moderately over the next 4 quarters, we are looking to optimize return to shareholders over the following ways -- through the following ways: one, continued investment in organic growth initiatives, such as the Analytics Hub that Adena referred to in her remarks; two, carefully consider M&A, especially tuck-in acquisitions that have great fit with our strategy and meet stringent investment return profiles, such as the 2016 acquisitions and our Sybenetix acquisition announced yesterday; three: continuing to grow our dividend as earnings and cash flow increase; and four, buybacks that principally offset the impact of share issuance and, when opportunistic, can additionally return larger amounts of capital.

With that, I'm going to turn things back over to Adena.

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Thank you, Michael. We are very pleased that our offerings continue to resonate with our clients, and our business continues to perform well for our shareholders. We're very focused on executing on our goals to drive our competitive position, optimize the benefits of our acquisitions and innovate with new technologies that meet and exceed our clients' expectations.

So with that, we're really excited to turn it over to questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Richard Repetto with Sandler O'Neill.

Richard Henry Repetto - *Sandler O'Neill + Partners, L.P., Research Division - Principal, Equity Research*

And first, congrats, Adena, you certainly carried on the focus on efficiency from your predecessor. So I guess the first question is on -- getting away from the efficiencies, but on the top line and the organic growth of the non-trading segments. Market Technology was huge in the first quarter, and you acknowledge it's going to be volatile. But I guess what's the outlook on the top line? I know you're making margin improvement from Corporate Services, but it seems like these other segments are still below that mid-single-digit number that you sort of put out there as guidance prior.

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

So what I would say with Market Technology, as we've been saying, and I said it in the first quarter even with that strong growth in that one quarter, that we have outlook, a long-range outlook, of mid to high single digits for the Market Technology business, and we continue to support that. So as we look at the first half of the year and because of the volatility, we do tend to look at as the year progresses as opposed to each quarter alone. We have had 10% growth in that business, and we continue to feel that, that supports our mid to high single-digit overall outlook for the business. I think with regard to our Information Services business, as you've seen, that has obviously had a nice growth this quarter with the growth in our AUM as well as just continued growth in our proprietary products. And overall, we're at 4% so far this year, and we continue to find opportunities to grow and expand that business. So I feel very comfortable with our mid-single-digit outlook for that business as well. And then for Corporate Services, we have said that that's a low single-digit grower as a general matter. And with the 1% so far this year, we continue to see opportunities to expand the bottom line, and we obviously continue to find ways to grow that business. But it is -- it's a lower grower, in general. And then on Market Services, which we do not give outlook for because volumes can be so volatile and changing over time, we are starting to see a recovery of volumes in the market, which has definitely helped the Market Services business in the second quarter. But what I focus on as CEO is those areas that we can control, which are market share and capture rates as well as functional enhancements and things that can drive businesses forward. And I really do feel that everyone on the team has really been focused on that, and we've been executing well against those goals.

Richard Henry Repetto - *Sandler O'Neill + Partners, L.P., Research Division - Principal, Equity Research*

Okay. And then my one follow-up would be -- I know this is a small part of your revenue and it's prior to your, I guess, return. But the Fixed Income, you did mention that you had some turnover at the leadership after very short period, and we -- you continue to have to put out 1 million shares to the acquirer. So I guess what's the outlook for Fixed Income? Is this -- it seems like a weak area, I guess. The share's been lost. But can you turn that around? Is it things that can rebound here on the fixed income, U.S. Fixed Income?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Yes. So when we look at our Fixed Income, our Fixed business more generally, we have the: U.S. Fixed Income or treasuries business; we have our U.S. futures exchange, which is focused on commodities; and then we have our Nordic fixed income business and clearinghouse as well as our Nordic power business. And I would say that the macro backdrop across our Fixed platform, in terms of volumes in general, have been -- has been low. I think that's been reflected across the industry. So that's definitely a challenging backdrop. In terms of our competitive position, specific to our U.S. treasuries business, we continue to find ways to enhance that platform and try to drive more volume back into the platform. It has been our biggest area of challenge, I would say, within Nasdaq. And I think that as we move all of those -- all of our trading businesses under Tom's leadership and into a single organization, we feel that we're going to be able to take all of the talent that really, frankly, has been extremely successful across our equities and options business, our derivatives businesses in Europe and apply that to those areas of challenge within the Fixed Income business. And I think that we will continue to work with our customers. And one of the great things that John did coming in was really bring a client orientation to that business, so we want to continue that and to try to drive progress. We had an enhancement on that we brought in, in June that basically create a new functionality around off the runs as well as creating more functionality in our elect offering, and we do hope that, that will drive more volume back on to the platform in the coming quarters.

Operator

Our next question comes from Chris Harris with Wells Fargo.

Christopher Meo Harris - *Wells Fargo Securities, LLC, Research Division - Director and Senior Equity Research Analyst*

Just a clarifying question on the expenses. Does the updated guide for this year incorporate any of the $10 million to $20 million of incremental synergies you guys have identified?

Michael Steven Ptasznik - *Nasdaq, Inc. - Executive VP of Corporate Strategy & CFO*

Yes, it does. That $10 million to $20 million won't all necessarily be realized this year. It'll be realized over the following periods as well. But yes, it does include that.

Christopher Meo Harris - *Wells Fargo Securities, LLC, Research Division - Director and Senior Equity Research Analyst*

Okay. But we're not quantifying how much potentially this year versus 2018, I guess?

Michael Steven Ptasznik - *Nasdaq, Inc. - Executive VP of Corporate Strategy & CFO*

No. We -- like I said, we're just including it in the overall guidance that we're now providing. And we've hit the $60 million. We think there's additional that we can achieve, but it'll -- we'll achieve it over future periods instead of continuing to track that separately. It gets harder as we start to integrate these parts of the business, which we're starting to, specifically, split out the synergies related to different aspects of it. So it's in the plans, and we have additional things that we're going to do. But as you start to try to suss it out, it gets a little more difficult. So we're just going to include it in our overall guidance.

Operator

Our next question comes from Vincent Hung with Autonomous.

Vincent Hung - *Autonomous Research LLP - Partner*

So what's the driver of the delta in the $10 million to $20 million of additional synergies? So what would lead you to be a $10 million versus $20 million?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Well, I would just say, I think that when we look at opportunities for us to continue to drive cost out of -- from a technology integration perspective as well as certain, I would say, agreements that we had with the sellers in terms of transition, we have the opportunity to find additional efficiencies in the way that we drive the operation forward, but also making sure that we're meeting certain criteria that allow us to roll off of certain agreements early.

Vincent Hung - *Autonomous Research LLP - Partner*

Okay. And just a follow-up on SMARTS. What is it as a percentage of revenues and order backlog right now?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

So we don't disclose SMARTS separately from the rest of the Market Technology business. But we are very pleased with the general -- obviously, that -- we had said that SMARTS is a double-digit grower, and it continues to be a very strong part of the overall Market Technology business. And we also would say that it is a subscription business, so it's a nice driver within in terms of the margins of the business as well. But it is something that we look at as, holistically, part of what we offer with our market infrastructure business, and we will continue to look at it that way.

Operator

Our next question comes from Kyle Voigt with KBW.

Kyle Kenneth Voigt - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

The first question, I guess, is on market structure. It seems like there's going to be, at very least, a pilot program that's going to be proposed to help understand the impact of lower access fee caps in the cash equities market. Just wondering if we could get updated thoughts on the potential impact to your business, if access fee caps were eventually reduced or eliminated over time?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Well -- so I would say that we don't see this as having a material impact on the net capture that Nasdaq or the exchanges, in general, receive because the goal of lowering access fees is to lower the rebates. So I think that that's, at the end of the day, what the SEC and certain participants are trying to achieve. We've been pretty clear in our position on establishing an access fee pilot. We attempted to do that on our own a few -- a couple of years ago, but the rest of the industry didn't follow. So as we look at what the SEC or what the industry is trying to achieve with lower rebates, which would come from a lower access fee, I think that we just want to make sure that we're cautiously going into that and saying, "Oh, what is the problem that we're really trying to solve for? And are we really going to be able to use this access fee pilot to really study and solve any specific market structure problems that exist?" The other area that -- of most concern to us is with small to medium-size companies and the liquidity in those companies. If we think about what rebates are for, rebates were established after decimalization because the spreads narrowed so dramatically that market makers were finding that they were not motivated to post liquidity openly and available for everyone to access and to see. So rebates were there to drive -- to motivate market makers to post passive liquidity onto the markets. And I believe that in less liquid stocks, those rebates are an important driver of nice, tight spreads in market maker liquidity. So we believe that we have to be very, very mindful and cautious as we walk into any sort of access fee pilot as to what problem we're solving and what potential unintended consequences could that -- could result. So we'll see how it progresses. But as I said, we don't see this as having a material impact on the exchanges' net capture. The purpose of it is to lower the rebate.

Kyle Kenneth Voigt - *Keefe, Bruyette, & Woods, Inc., Research Division - Associate*

Okay. And then just one follow-up on the Sybenetix deal. It really grows the compliance offering that you have. But also, since you expand the offering more into the buy side, just wondering if you could help us understand the strategy and whether you think the client -- that client base, that buy-side client base is a significant opportunity for Nasdaq going forward and maybe also an area of focus for inorganic growth.

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Sure. So well, I think it is good to point out, when we bought SMARTS back in 2010, that business was really primarily driven by providing surveillance solutions to exchanges and regulators. And we started to realize that market participants or the sell side also have very sophisticated trading that they do, and they could leverage exact same alerting and same capabilities to look at their own internal trading behavior and the trading behavior of their client. And so we started -- and we embarked on a program to bring SMARTS into the sell side, and today, we have 140 market participants that use SMARTS surveillance as their core surveillance system. So it's been a very successful strategy over the last 7 years. And when we then look at how the buy side is becoming more and more sophisticated in terms of their interactions with the market and their own regulatory obligations have been increasing over the last several years, our view is that the same surveillance and, frankly, the behavioral analytics approach to surveillance that Sybenetix brings is also going to have increasing demand within the asset management industry. So it does open up a new avenue for us to continue to grow and expand our surveillance offerings. So we actually identified this as a strategy for Nasdaq about 1.5 years ago. We've been building out the SMARTS surveillance buy-side solution. We have clients in the buy side already using it, but Sybenetix really helps catalyze that growth and brings an orientation to that surveillance that and we think is very relevant to them. So we're very excited about that. I think in general, the asset management industry is clearly an area of focus for us right now with our Analytics Hub and with our SMARTS surveillance offering as well as other things that we'll continue to look to do and, obviously, our index business and data business to continue to drive demand there.

Operator

Our next question comes from Alex Blostein with Goldman Sachs.

Alexander Blostein - *Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst*

Adena, I want to actually pick up on the last point you mentioned around Analytics Hub. Clearly, the growth area within asset management has been around quants recently. I'm assuming obviously that's kind of the area where you guys are trying to tap into. So could you spend a couple of minutes just discussing the opportunities you see there for Nasdaq, how you guys thinking about partnering versus acquiring capabilities in this area and, I guess more importantly, where are the synergies that you guys see between kind of that kind of customer base versus your existing customer base?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Sure. Well, it's been -- I would say that we do have a strategy internally to look at how we can expand the value-added data that we provide to the entire industry, both the sell side and the buy side, as well as to brokers that service the retail audience. And what we want to make sure of is we look at leveraging our own data that we have internally and finding signals within that data using machine intelligence, in addition to bringing in other third-party data that provides, what I call, more driver information that would be relevant for a quantamental shop or a pure quant shop that's looking at ways to find used data to make a fundamental decision or using data to make a technical decision in terms of their investments. We want to make sure we build out this hub. We definitely like the idea of partnering with other exchanges, partnering with our clients to find those signals to bring in the data that they're looking for and to serve their needs. And one of the things that we're really proud of is how we've architected the solution because it's completely in the cloud, it allows for us to -- allows the client to come in with multiple types of interfaces, it could fixed or it could be APIs or it could be -- we can multi-cast the data out. They can provide data into the platform. They can get as much data or as little data as they want out of the platform. They can do it in real time or at end of day. It's an extremely flexible platform, and it allows us to grow and expand what we're doing in multiple ways. So it is meant to be for the entire industry. But certainly, the quantitatively oriented buy-side strategies we think are good starting point for us to focus our energies.

Alexander Blostein - *Goldman Sachs Group Inc., Research Division - Lead Capital Markets Analyst*

And then just to follow up around, again, some of the newer initiatives around the Index business. It seems like competition in the space is definitely heating up and, I guess, not surprising, given kind of pricing pressures on ETF managers. Can you guys discuss the pricing in your Index business versus some of the larger incumbents and how much of a driver, I guess, has that been in you guys picking up some share recently?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

We actually are really good at partnering with ETF sponsors to make sure that we're both happy, and it kind of depends on the type of index that we're creating. So if it's a very advanced, I would say, smart beta index, like we get -- we have from our Dorsey Wright business, we actually -- we do tend to see that that's got higher value and there's more IP that we're bringing to the table. That tends to have a higher price point versus a benchmark index, where we really do try to partner to be a low-cost provider to our ETF sponsors. And so it really just depends on the type of index that we're calculating on behalf of our clients or that we're generating and then targeting with our clients to bring to market. And we do have a wide range, and we're very partnership-driven.

Operator

Our next question comes from Alex Kramm with UBS.

Alex Kramm - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Exchanges, Ebrokers*

Just wanted to come back to the beginning. I think it was Rich's question on the organic growth, particular on the Market Technology side. I appreciate kind of your comfort level with the overall full year outlook of high single digits. Just wondering a little bit more near term in the third quarter. If I look at typical seasonality, I think the growth will be roughly in line with the second quarter again. So just wondering, is there anything else you would point out that may swing this a little bit higher or lower? Any new business wins that might come in the third quarter that we should be thinking about as we think about our model?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Well, we won't pre-disclose business wins, but we definitely have -- we are working with a lot of clients right now to make sure that they understand the value of our offerings. We have some clients that are, frankly, in, what I would call, predevelopment mode. But we -- I -- all I can say, Alex, is we do continue to see really high demand for our services across the entire spectrum of what we do, whether it's risk management, trading, clearing, settlement. Those -- clearing and settlement continue to be very strong growth drivers for us, in addition to the surveillance offering. So we -- I can't give you any sort of specific things, but I could say that we continue to have very high demand across the suite of what we offer. In terms of the third quarter, I mean, you are right that from a, what I would call, change or class perspective, that tends to be a lower quarter for us, because not only do -- really, our clients have more vacation time so they tend to demand less in terms of enhancements and that the fourth quarter tends to be our strongest quarter in that. So that is some of that seasonality that you do see. But in terms of general -- our general view is that we continue to see very high growth drivers overall, but we're not going to speak specifically to the third quarter.

Alex Kramm - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Exchanges, Ebrokers*

All right. Fair enough. And then just maybe stepping back for just a minute. Last time I spent time with the management team, I kind of sense that in addition to spending more time on capital allocation, you also thought, I think, a little bit more about resource allocation. I guess I mean, hey, you have several different businesses here, some may benefit and actually have an opportunity for acceleration and growth if you drove more resources to them, where some are a little bit more in "let's maximize the returns or the margin mode. Any new thoughts you're having as you've now spent a few more quarters here at the helm where you may want to change a little bit of where you're spending more time or less time in terms of dollars, time, et cetera?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Well, I think the -- our general approach is for those businesses that are strong incumbent businesses, we try to drive it to the greatest efficiency that we can to make sure that -- but while we're still optimizing the business and its opportunities. But then as we look at really specific growth initiatives and ways for us to invest our resources, as you said, our people resources and our capital resources, we try to make sure that we give you some disclosures around those areas where we're really investing a lot of time and capital. So what we've been discussing with you in terms of -- you can kind of see that in terms of which initiatives we've been highlighting to you, so the Nasdaq Financial Framework is clearly an investment area, surveillance is clearly investment area, the data business is clearly an investment area, NASDAQ Private Market is clearly an investment area and then NFX is our trading investment area. So I think that those are where we try to make sure you know where we're kind of moving resources into those areas to drive growth, and we're trying to make sure that the rest of the franchise is as efficient as possible.

Operator

Our next question comes from Michael Carrier with Bank of America Merrill Lynch.

Michael Roger Carrier - *BofA Merrill Lynch, Research Division - Director*

First, on the technology side of the business. Obviously, the trends there have been favorable. I think '16, you had a bit of a tough comp, just given some of the timing of some of the projects that came on, like Istanbul, but yet your pipeline's at a record. So I'm just trying to understand, and this isn't for the -- like a quarter or anything, but if I'm looking over the next, like, 4 quarters, has anything changed on the timing of sort of the revenue recognition of the current pipeline? Meaning, as things shift, either do we maybe a little more regulatory-driven. Does the timing shorten versus lengthen? Or should we continue to expect kind of the same pace of revenue recognition on that pipeline?

Michael Steven Ptasznik - *Nasdaq, Inc. - Executive VP of Corporate Strategy & CFO*

Yes. So I think the one thing that you'll start to see is as more of the business moves to more of a SaaS-based model, and those contracts are more annual-based contracts or shorter periods as opposed to some of the 5- to 7-year type contracts that you would see in the core business, and as we continue to build out the things that Adena has been talking about with respect to the SMARTS surveillance business and the whole SaaS business, that those contracts are -- that does change the nature, to some degree, of that backlog that we're looking at. So we are actually looking at are there alternatives ways of presenting some of that information to you guys going forward. But -- so some of it is more of on a recurring basis, (inaudible) shorter-term recurring basis as opposed to longer-term contract. And so that will change the nature of that a little bit and how we recognize it. In addition, looking into next year, we are looking at what the implications are of the new GAAP requirements. We don't think that there's going to be a material impact overall in the way that the information is reported, but it will have a bit of an impact. So there'll be more information coming out the next couple of quarters as to how you start to recognize that in the back half of the year.

Michael Roger Carrier - *BofA Merrill Lynch, Research Division - Director*

Okay. And then Adena, just a quick follow-up on some of the stuff on strategy, maybe like 2 areas. Just in terms of the paper that you guys put up in terms of improvement in capital markets, just wanted to get a sense on what's the reception been, particularly on the political regulatory side if some it's driven on that angle. And then just getting your guidance focus on blockchain, artificial intelligence. Just wanted to get your sense, when you're working with a client, it seems like there's a lot of interest. But when do you see that kind of conversion versus interest versus like a more meaningful revenue opportunity?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Okay, great. So on revitalize, I think that we have had a very, very positive reception across many aspects of our client base and as well as the lawmakers. What I really like about the fact that we took a leadership position in coming out with our views on the capital markets and what we can do to improve the capital markets is that we've been able to elevate the discussion to the bigger-picture issues that are really facing the country and the economy as it pertains to getting more companies to want to enter the public market and what are the benefits of the public market to investors and to companies. So we like this -- there is a one step that we have in the revitalize blueprint that talks about the fact that, in the last decade, 76% of all job growth has come in these companies after they've gone public. So going public is a job creator. It is a growth driver for the economy. And so we want to make sure that lawmakers, regulators, issuers, investors and market participants are all engaged appropriately on those issues that actually matter. And what's been great is that it has elevated the discussion and debate on those topics that are bigger-picture topics, like proxy access, disclosure obligations, tax reform, litigation reform as well as market structure. So market structure isn't the only thing on the agenda anymore. It's looking holistically at the system. And we have been heavily engaged with lawmakers and with regulators on the topic. It's gotten a very positive reception. I think that there's also some elements of -- there are certain areas that not everyone agrees on, but what we've really wanted to do is get an active and open debate on the topics, and I think we've been successful in that. So we do hope that we're going to see progress on some of these current issues.

We're really pleased to see that Chairman Clayton took as one of his very first acts to allow for confidential filings at every level of the company size. That's a perfect example of a change in disclosure obligations that we support. So we're hopeful that we can actually drive positive change there. In terms of the blockchain and AI commercialization, there is -- those new technologies are going to take time to seep into the financial fabric of the economy, but we have seen -- what I really like about the blockchain is that I think that it kind of came to market as a solution looking for a problem. And then there are some problems that were identified, so particularly in illiquid OTC instruments, where there are bespoke trades that are done and they take forever to settle. And so you're standing out there with a lot of risk waiting for those trades to settle, and there is just not an efficient system to support that. In the blockchain, whether it's the NASDAQ Private Market and are alt initiative or whether it's distribute ledger technology that X is looking to bring into their OTC market, the whole purpose of it is to create a more efficient and effective way to settle out trades that then lowers the risk of doing those trades, which then lowers the capital requirement. So we have -- we've definitely keyed in on problems that are solved with the blockchain and we are moving forward with commercialized business opportunities with the blockchain and the Nasdaq Financial Framework. On AI, as you can tell, we, obviously think that there's a lot of opportunity there across our data products, our surveillance products and our IR products, and we are actively working with machine intelligence and bringing those products to market. It just takes time for the clients to trial them, to back test them to make sure that they are, in fact, doing what they hope they will do. And it just -- it's just a time issue of working with the clients to get adoption. But we're highly confident that the solutions we're bringing to market are valuable to the customers. So that's just a matter of time, I think, Mike, to get that adoption up.

Operator

Our next question comes from Brian Bedell with Deutsche Bank.

Brian Bertram Bedell - *Deutsche Bank AG, Research Division - Director in Equity Research*

Adena, if you can just expand a little bit on the revenue opportunities from Nasdaq Analytics Hub. But I appreciate all the color on this. That sound like sort of exciting new area. But if you can talk about -- I know it's early. But if you can talk about what you envision as the revenue expectations, and maybe too early to the second half this year, but certainly coming into 2018 and if that alters your long-term mid-single-digit growth outlook in Info Services at all.

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Well, I would say I think we need to have more experience with it and working with the clients very extensively to understand the total breadth of the opportunity. It is -- in a way, it's kind of an interesting project for us. Because when you're going into a highly competitive space where you kind of know what the total addressable market is and you're trying to grab at it, it's easier for you to come up with projections as to -- if I progress this way, I will get this money. In Analytics Hub, it's a whole new thing. It's something -- these are products that clients have never had access to before. It's a very -- it's a new space. So the total addressable market, in a way, is kind of unknown. And so what we are looking at is how do we just -- obviously, we have our own internal targets. But in terms of our expectations and how quickly these targets will be met, we are not providing those publicly because we do want to have more experience with the technology and with our customers to know what fits their needs and how they're going to be adopting it before we give you any sort of true, clear guidance or outlook on that particular part of the business. We are doing this as a subscription. And as they -- so we -- the way it's priced is you pay monthly fee for either a third-party data set or you pay different monthly fee if you want to take analytics on that data set. And so there are -- there's established pricing that we're working on and making sure that the clients are seeing it as a subscription service. But we don't yet have targets that we're able to communicate to you.

Brian Bertram Bedell - *Deutsche Bank AG, Research Division - Director in Equity Research*

Great. I'm sorry you said that you're piloting this right now with -- did you say 20 clients? Or was that something else that I...

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

That's right. We have 20 clients who are piloting various aspects of the data. So they may be piloting one data feed, they may be piloting all the data feeds, they may be looking specifically at the analytics that we're creating. And what they're doing is back testing it against their models and making sure that they -- those models do, in fact, get a positive impact from the data. That's what they're doing at the moment.

Brian Bertram Bedell - *Deutsche Bank AG, Research Division - Director in Equity Research*

Got it, okay. Then -- and Michael, just on the M&A strategy broadly and, I guess, Adena as well. The -- obviously, you want to be opportunistic in that, and thanks for the priority outline on the capital deployment. But as you think about opportunities going forward, do you look at debt flexibility? In other words, I know you're trying to get to 2.5x on debt to EBITDA next year. Would you be willing to flex that back up to 3x if you saw more important opportunities? And maybe Adena, if you just want to highlight again on your M&A priorities in terms of what businesses you'd like to try to look at.

Michael Steven Ptasznik - *Nasdaq, Inc. - Executive VP of Corporate Strategy & CFO*

Well, I would say from a financing standpoint, the priority is identifying if we have good opportunities. We'll look at the best ways to financing those opportunities. And if it means that you're increasing the debt for a short period of time, we would look at doing that. But the priority is getting the investment. And we think it's a good strategic and financial return to the company, then we'll look at the best way to finance that. And with that, I'll turn to Adena to...

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Sure. I mean, I would say that we are very committed to our investment-grade status. We've been very proactive in working with the rating agencies to make sure they understand our business well. And we will -- I mean, the purpose of having debt capacity is to use it for the right opportunities. But when we look at the opportunities that are before us right now, I think that what Michael discussed in his capital allocation outline is where we're focusing our energies right now, which are on these kind of, I would call them, bolt-on A type of deals, where it adds a capability to -- a technology capability to us, it expands our market presence in a certain area or, in the case of the deals we did last year, which their highly synergistic, basically doubling down in areas that we believe in -- that we believe can grow and expand our franchise. So we're -- those are the areas that we're particularly focused on right now, and I think that, that will play out, hopefully, as we continue to expand our business.

Operator

Our next question is from Ben Herbert with Citi.

Benjamin Joseph Herbert - *Citigroup Inc, Research Division - VP & Analyst*

Just wondering if you could provide some context around MiFID II in Europe, where you see maybe opportunities or risks around that next year.

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Well, we have been very focused on making sure that we're compliant with MiFID II, and that's got a fair number of work streams across our technology organization, our business organization in the Nordics. And it is -- it's a big project, not only for us. It's a much bigger project even for our clients. But we see -- the auction on demand functionality that we launched in June on our Nordic market is a direct reflection or a direct reaction to MiFID II. In terms of allowing people -- I think the general goal of MiFID II is to bring more flow into lit venues and into the exchanges, which I think that is benefiting us. But the auction on demand allows people to execute their strategies as large as institutional players and still do it within an exchange environment and make it to that -- the systematic internalizers that don't have as much of a motivation to take that type of activity off exchange. And so we are doing those types of enhancements to our systems. We're also continuing to look at the disclosure obligations and whether or not there are opportunities there to enhance our disclosures in our data to help people comply with MiFID II. But I would say also, MiFID II and the new M-A-R or, MAR, obligations are really, really helpful, have been helpful to our SMARTS business and its demand for surveillance in Europe over the last couple of years. And so we've seen that as a growth driver for us, and that's been benefiting us.

Operator

Our last question is from Alex Kramm with UBS.

Alex Kramm - *UBS Investment Bank, Research Division - Executive Director and Equity Research Analyst of Exchanges, Ebrokers*

Just to -- now i came here for a follow-up. NFX. I think, Adena, you mentioned NFX at the beginning as continuing to gain open interest, building open interest, et cetera. When I look at volumes, I feel like the growth over the last 3 quarters has stalled a little bit. And if you look at your competitors, I mean, I think their comps are looking a lot better, obviously, different businesses. But just wondering, like, you're very excited about open interest. It's not translating into volume. Like where's the differential coming from, I guess?

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Sure. So I think that when we look at how our clients are using NFX, they're using it for -- they're using it definitely to trade on it, and they're using it to clear. And they -- and then sometimes, they can do internalized prints that they then just send into the system to clear. And that then drives the open interest, but they may not actually be using the -- what we call the CLOB, or the limit order book, to trade. And so -- but both of those things are beneficial to the health of the platform. The fact that they're willing to put their risk into the clearinghouse on long-duration related contracts, we feel, is very, very healthy and encouraging, and I think that, that helps us to generally drive client demand to get connected and to be a part of NFX. In terms of the volumes on the system, we have seen -- we've been introducing fees, and we introduced fees at the beginning of May. And as the market makers and other participants have been getting used to these fees, we have seen some moderation of volumes. But honestly, we continue to see new participants joining. We've had a couple of new firms joining as partners in the last couple of weeks. And definitely, there still is very strong demand to continue to develop the platform and bring on new products and new activities. So we see this as maybe a little bit of a plateauing, just based on them getting used to in a fee-based. But we're pretty -- we're still very encouraged and optimistic about the business.

Operator

Thank you. This concludes the Q&A session. I would now like to turn the conference back over to Adena Friedman for closing remarks.

Adena T. Friedman - *Nasdaq, Inc. - CEO, President & Director*

Thank you very much. Well, thank you very much for your questions. And we are, as I mentioned before, we are very proud of the business. We're proud of all of the opportunities we have to continue to grow the business and engage with our clients, and we hope that we were able to convey that today.

So thank you very much.

Operator

Ladies and gentlemen, this concludes today's conference. Thank you for your participation, and have a wonderful day.
