

FINAL TRANSCRIPT

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ITG - Q2 2006 Investment Technology Group Earnings Conference Call

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PRESENTATION

Operator

[Operator Instructions] As a reminder, ladies and gentlemen, this conference is being recorded. I would now like to turn the conference call over to Maureen Murphy, ITG's Director of Marketing, Corporate Communications and Investor Relations. Please proceed, ma'am.

Maureen Murphy - *Investment Technology Group - Director of Marketing, Corporate Communications and Investor Relations*

Thank you and good morning. In accordance with the safe harbor regulations, I would like to advise you that the forward-looking comments we will be making this morning are subject to a series of risks that may make actual results to differ materially from our expectations. I advise you to read about these risks in this morning's press release as well as in our SEC filings. I would also like to encourage you to visit the Investor Relations section of our website which contains a full reconciliation of the non-recurring items mentioned in today's press release as well as PowerPoint slides to accompany this presentation. I would now like to introduce ITG's Chairman, President and Chief Executive Officer, Mr. Ray Killian.

Ray Killian - *Investment Technology Group - Chairman, CEO, President*

Thank you, Maureen. Good morning and thank you all for joining us to talk about second quarter results. It has been a very active quarter for ITG on a number of fronts. Our US volumes and market share hit record levels. As a corollary to this volume growth we moved ahead aggressively with our investment to expand our capacity for the next level of growth.

We took some significant steps forward in integrating our execution technology with Macgregor's order management system. Our DarkServer algorithm grew rapidly, tapping into one of the areas of greatest concern to traders today, that is fast routing to liquidity sources. In fact, we estimate that 60% of our customers are now using our algorithmic trading suite. And we continue

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to expand our product offering in our growing international markets in Europe and Asia. In terms of the results, it was a record quarter for ITG. Our strong growth reflects the industry trends that continue to favor electronic trading technologies. And it reflects the versatility we've built into our own business model to capture all kinds of volumes in a variety of market conditions. As you know, electronic trading is constantly changing and we continue to manage the business in a way that allows us to continue investing in our future growth.

Our ability to capture a broad trading mix is an important part of our strategy to diversify our product offering, and we saw that strategy validated in the second quarter as volumes surged in our direct market access business. As you know, direct market access executions command lower commissions than some of our other services, so you can see the impact of this volume increase in our overall revenue capture. But capturing trading volumes as market volatility fluctuates is an important form of diversification that provides more stability to profits and gives us additional revenue streams.

In addition, we've delivered on a number of initiatives that we announced a year ago, in the second quarter of '05.

We re-branded the POSIT suite of products and launched POSIT Alert. We expanded our algorithmic trading suite. We opened our Japanese office. We are integrating the Macgregor and Plexus acquisitions, and we've gained over \$12 million in business to our trading desk as a result of improved connectivity to Macgregor order management system. And we continue to integrate our comprehensive suite of products.

Revenues for the quarter were up 50% year-over-year to 153.6 million, net earnings were up 60% to 27.9 million. And earnings per share were up 54% to \$0.63. Operating revenues reached an all-time record of 148.1 million compared to 99.5 in the year ago quarter. Operating EPS was also a record, at \$0.56, up 47% year over year. ITG volumes strongly outperformed the market. For the second quarter, our total US volumes were 9.8 billion shares, or 156 million shares per day, which is an increase of 56% over last year's second quarter. Looking at trading volumes in the overall market, NYSE volumes were up 23% and Nasdaq up 21%, so ITG continues to gain market share.

As I mentioned, ITG's volumes and market shares continue to demonstrate strong growth in a variety of market conditions. Our market share, calculated as a percentage of combined NYSE and Nasdaq reported market volume was 3.85% versus 3.19% for the second quarter of '05. The Russell index rebalancing occurred near the end of the quarter, which always provides some boost to our volumes. The rebalancing this year however, involved fewer companies moving in and out of the index than in some years, so the volume impact was not as significant. As an indicator, there were 290 companies added to the Russell this year and 278 companies dropped. This is similar to last year's low level, but is well down from the higher levels in recent years.

In 2002, for example, there were 486 companies added and 386 dropped. Nonetheless, ITG did very well this year and took a large share of the Russell rebalancing in a flattish rebalancing. Looking at the overall environment, the net new funds flow to equity mutual funds has slowed recently. In the second quarter, the funds flow was a positive 21 billion, which is down from about 90 billion the first quarter. In June, there was actually a negative flow out of eight billion, which is the first negative number since February, 2003. International funds were actually up a bit, so all the decline has been in domestic funds.

Volatility made a sudden comeback during the second quarter. After languishing around 10 to 12 on the VIX for most of the past year, the VIX volatility index shot up to 24 during June, although it has come back down to around 14 recently. The immediate impact of such sharp spikes in volatility can have a negative short-term impact on our price mix by leading traders to seek immediate execution through our direct market access systems rather than wait for the next match in our crossing systems, where we get higher price realizations. However, persistent volatility is good news for our front end. In short, diversification works. In past years we would not have been able to capture these active execution volumes.

As has been the trend, pricing continued to be under pressure during the quarter. Our average US realizations were down about 14% below last year's average. This reflects the overall competitive environment, some particularly large market on close orders related to the MSCI Index rebalances and Russell rebalances and some mix shift related to the distribution I mentioned. The

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important thing is that our diversified model is proving very successful in capturing whatever mix develops in the market, building our volumes across our product offerings and increasing our total market share.

The second quarter was a great quarter for ITG's direct market access products, especially for Triton which delivered a 100% increase in volumes year over year. And as we've said many times, our strategy has been to gain desktop real estate and increase volume through the deployment of our direct market access products, including Triton, Radical and ITG Channel.

We saw the results of this strategy in the second quarter, with active users increasing across the board. We see this primarily as relating to our interconnected suite of products. For example, as more customers utilize our POSIT crossing suite, we see an increase in the use of direct market access and algorithmic trading products. This also had an effect on our revenue mix, and related revenue capture, which we'll discuss in more detail later.

The POSIT suite also continued to experience growth in the second quarter. POSIT was the largest crossing network in the second quarter in terms of average daily volume, executing over 50% more volumes than in the second quarter of '05. POSIT continues to benefit from the increased integration of ITG's products, including our direct market access products and algorithmic trading suite. Growing a crossing business is as much about integration and seamless access as it is about the mechanism itself. We're confident that this suite of integrated products is going to help position POSIT for continued growth in this competitive environment.

As you may recall, last year we acquired from Morgan Stanley and Barra the 50% interest in the POSIT joint venture that we didn't already own. The terms of the deal included a contingent consideration of 1.25% of revenues payable over the next ten years. We are confident in the future growth of POSIT and in the second quarter ITG elected to accelerate the remainder of the payments to satisfy the future consideration obligation. We expect this payment will be approximately \$11.5 million, based on the present value of our estimated future payments, and will be made in September of 2006. We believe the timing is advantageous based upon our future growth estimates for our POSIT suite of crossing solutions and we expect to save a considerable amount in future royalty payments.

International has been gaining real traction over the past year. International currently represents 21% of our broker-dealer revenue and we believe it has the potential to go about 40% over the next few years. That said, Europe was down in the second quarter versus the first quarter. We had some large transactions that made the prior quarter a high comparison, and we also saw an increase in market volatility that pushed the Europeans toward more principal trading during the quarter. We're more vulnerable to volatility in Europe because we've not yet rolled out the full suite of ITG products as we have in the US. And as I said previously, in the US we've been able to hedge our exposure in volatile markets due to our mix of products including the POSIT Suite, DMA, algorithms and pre- and post-trade analytics. We expect to be in a more diversified position in Europe by mid-2007.

I visited Europe twice during the quarter and I remain fully confident the underlying trends there. There's been significant European press coverage of ITG's products and we expect this to continue as interest in products geared towards best execution increases. We are still early in the rollout of Triton and our algorithmic suite in Europe and both are generating high levels of interest. We have nine Triton installations in Europe, including three major global firms that are using the system on both sides of the Atlantic. We still see momentum in International this year as we leverage our increased growth in Europe and we're going to invest heavily in building Asia into another significant growth platform. I'll say a little bit more about the International opportunity in a few minutes when I address the strategic developments. But first, our CFO Howard Naphtali will take us through the details of second quarter results. Howard.

Howard Naphtali - Investment Technology Group - CFO

Thank you, Ray. This was a record quarter for ITG in terms of US volumes, consolidated revenues and earnings. ITG's revenues grew 50% versus the previous year, and 5% versus the trailing quarter. The second quarter includes a \$5.4 million pre-tax gain

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related to the sale of our 50% interest in a Canadian joint venture with IRESS in April as discussed with you on our first quarter call. This sale resulted in a net income of \$3.2 million or \$0.07 per share. Excluding this gain, operating revenues grew 49% versus the prior year, pre-tax earnings increased 69% to 41.8 million while net income grew 55% to 24.6 million. Compared to the trailing quarter, operating revenues increased 7%, pre-tax earnings grew 15% and net income 14%.

For the year to date, on an operating basis, excluding these non-recurring gains, revenues have grown 50% to \$286.6 million, pre-tax profits 67% to 78.2 million and net income 59% to 46.1 million and earnings per share 52% to \$1.05. This consolidating slide provides visibility into the operating results of our core US broker-dealer operations, the impact of Macgregor and Plexus and our international operations for the quarter. And as you can see, the core US business was strong as our US earnings per share for the second quarter from our broker-dealer activities were \$0.53, while our International activities performed admirably considering the difficult conditions in Europe and generated an additional \$0.02, so that, combined with \$0.01 of earnings for Macgregor and Plexus, consolidated operating earnings per-share were a record \$0.56.

In the second quarter, the combination of Macgregor and Plexus generated revenues of \$16.8 million, of which 14.5 million or 86%, were recurring. Pre-tax earnings were 4.5 million before interest expense and were \$1.3 million on a GAAP basis after interest costs of 3.2 million, resulting in \$0.01 contribution to earnings per share for the quarter as I mentioned a minute ago.

We expect second-half spending for these acquired companies to increase, in the aggregate, over the first half as we invest in improvements to both products and support infrastructure although we continue to expect \$0.04 of earnings accretion in 2006 from the standalone financial performance of these acquired businesses. In evaluating the overall contribution of these activities to ITG's first half results, we need to consider incremental brokerage commissions from their customer bases, which has exceeded \$12 million since we now have equal access from a connectivity perspective. These revenues are included in our core US broker-dealer revenues.

The next three slides are designed to provide a comparative view of both our International and our US broker-dealer performance excluding Macgregor and Plexus so that you can easily measure the growth of these activities. These US broker-dealer operating earnings per share for the second quarter are up 51% from last year as average daily volumes grew 56% to a record 156.2 million shares per day. Our earnings growth clearly reflects the leverage in our business model as US broker-dealer pre-tax margins increased from 29.8% to 37.1% in the quarter. Our International operations earned \$0.02 for the quarter with the \$0.01 EPS decline versus 2005 due to the increased share count as pre-tax earnings actually increased \$200,000.

For the year to date, our US broker-dealer operating earnings per share have increased 55% over last year driven by a 49% increase in average daily share volumes to 145.9 million shares per day. Despite continued infrastructure and technology investment, our revenue growth drove pre-tax margins to 36.6% compared to 29.5% in 2005. And the continued positive traction in our International business added \$0.06 of earnings despite significant investment in Japan, to yield operating earnings of \$1.05 for the year to date.

Consolidated broker-dealer expenses were \$90.8 million, representing a \$16.2 million increase from last year. This relates primarily to compensation costs, as well as transaction processing costs which correlate with our volume growth and higher general and administrative costs. When compared to the trailing quarter, consolidated expenses increased \$5.9 million from the \$84.9 million level incurred in the first quarter. Variances in the major cost categories are as follows: Compensation costs grew 6.4 million of which 4.8 million pertains to the US and 1.6 million to the International business, including a \$300,000 currency impact. US compensation costs were 32% of revenues, versus 34.5% in the first quarter and 36.7% in the prior year, due to a change in revenue mix and a 1% impact each versus the trailing quarter from payroll tax fall-off and the heavy new product development investment, which is capitalized from the point technological feasibility is established until product release. In addition, our 2005 numbers included a six-month catch-up on profit sharing and performance based incentives due to a strong second quarter 2005 performance that had a 2% impact on the compensation rate. On the International front, \$1.2 million of the compensation growth pertains to Canada, where our operating revenues grew 3.8 million. We also incurred \$250,000 of compensation costs in Japan.

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Transaction processing costs grew 5.6 million with a \$4 million increase in US costs due principally to the 35 % revenue growth, as well as increased execution costs deriving principally from accessing other crossing systems for liquidity in our DarkServer. Commencing on August 1st, the New York Stock Exchange has increased pricing to 2.5 mills per share. At our current run rates, we anticipate this will add approximately \$200,000 a month to our costs in the short term and we're obviously looking at ways of mitigating this cost increase. For example, as NYSE market share migrates to other executions venues, we will likely be sending our volumes to less expensive sites.

For the International business, the \$1.6 million cost growth correlates with the \$5.3 million revenue growth. Occupancy costs grew \$1 million and telecommunication costs increased a further \$900,000, consistent with the guidance provided to you on our February 1 call, when we discussed expected fixed cost increases as we build out our infrastructure to support anticipated growth. Other G&A costs were up 2.3 million to 13 million, reflecting continued aggressive business development efforts, our branding initiative and recruiting efforts.

Moving back to our international operations, you can see the breakdown of the record \$28.2 million of International revenues for the quarter. The strength of the US dollar drove a \$1 million increase in revenues principally attributable to the strength of the Canadian dollar. On a pre-tax basis, our combined Asia-Pacific region operated at break-even as Australia lost \$200,000 pretax on 2.2 million of revenues. Hong Kong had another outstanding quarter with \$2.9 million of revenues and \$800,000 of pretax profits while our Japanese loss was \$600,000 the quarter. Canadian results were outstanding with revenues at a record 12.3 million and pre-tax profits at a record 2.7 million driven by record client site volumes up north. European revenues were 10.8 million which yielded a pre-tax loss of \$450,000 after \$1.5 million of development costs in Israel which is reflective of continued aggressive spending focused on growing and supporting the global product offering.

Second quarter European product revenues were 5.7 million pounds versus 5.6 million in the prior year and 6.7 million in the trailing quarter. This was the second-best quarter in terms of European revenues despite difficult market conditions. From a market perspective, according to London Stock Exchange statistics, the value of UK "customer business" in the second quarter of 2006 declined 11% versus the first quarter. As Ray indicated, we saw much greater volatility in our key European markets during the second quarter, which favored principal versus agency trading. When we roll out the complete suite of ITG products in Europe, we'll have a more diversified product set like we have now in the United States which should lessen our exposure to such market volatility.

As we enter the third quarter, we must voice the usual level of caution with respect to our European operations, considering the low volumes typically achieved in the European market during the summer vacation period. For your reference purposes, our July revenues have averaged just under 90,000 pounds a day which is on par with the 91,000 average in the second quarter. For the quarter, we earned a 461,000 pound pre-tax profit in Europe.

Turning back to the company as a whole, in the second quarter, average consolidated revenues were 2.351 million a day, a 51% increase over the second quarter of 2005 and 5% versus the trailing quarter. US broker-dealer revenues of 1.638 million per day were up 37% over the last year and 8% versus the trailing quarter while International revenues of \$447,000 per day were up 25% versus last year and roughly equivalent to the trailing quarter.

The key driver of our performance, our US daily trading volumes, grew 56% versus the second quarter of 2005 and 15% over the trailing quarter as we experienced strong growth across our entire product spectrum, particularly from the POSIT suite, Triton, and our algorithm trading products. The blended revenue capture per share during the quarter was \$0.0101 versus \$0.0109 in the preceding quarter and \$0.0118 in the second quarter last year. The reduction in revenues per share is due to the change in product mix as Ray described. Where a greater percentage of our executions occurred in our direct market access and algorithmic trading products as opposed to our electronic trading desk, where we earn our highest commissions per share. In addition, there were several significant portfolio trades that were competitively bid as well as general market pricing pressure. The overall revenue growth speaks for itself in a trading environment marked by greater volatility which Ray also discussed earlier. Our more diversified equity business model drove an increase in market share and in market conditions that would have been very difficult for ITG several years ago.

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During the quarter, our pretax margins were 28.2 % for ITG as a whole, 33 % for our total US business (which now includes Macgregor and Plexus) and 37.1 % for our core historical US broker-dealer business. Consolidated margins, excluding Macgregor and Plexus, would have approximated 30.8%. The margin improvements versus both the prior year and trailing quarter are reflective of the positive leverage in our business model when we experience revenue growth.

Diluted earnings per share in the second quarter were \$.56, which was up 47 % versus the prior year. Our effective consolidated income tax rate for the second quarter was 41%, while the US tax rate was 40.1%. During our February 1 call, we advised you that our 2006 estimated shares outstanding would likely approximate 44 million shares as certain performance-based shares granted in 2004 met criteria that adds them to the diluted share calculation. Since our 2006 performance for the year-to-date has exceeded our expectations, our second quarters shares outstanding was already almost 44.3 million shares, which we would now expect to increase to approximately 45 million shares outstanding by the fourth quarter. That concludes our financial highlights. I'll now turn it back to our Chairman, President and CEO, Ray Killian.

Ray Killian - Investment Technology Group - Chairman, CEO, President

Thanks, Howard. As I mentioned, previously, we continue to ride a number of powerful trends that are reshaping the trading industry today. Three of the most important involve best execution, hedge funds and international.

The renewed emphasis on best execution is being driven by the intense pressure on the buy-side today from regulators, competitors, plan sponsors and mutual fund trustees to deliver the added performance that comes from getting trades done in the most efficient manner and to do so with much greater transparency than in the past. The unbundling trend is one manifestation and continues to gain momentum. A study released by the TABB Group in June showed that while only a small percentage of US buy-side firms have actually moved to bundling so far, the large majority of sell-side firms report having had recent discussions on unbundling with their clients.

According to the study, less than 25% of the buy-side believes that unbundling will lead to a significant reduction in the amount of research available. But over 80% believe that the primary impact of unbundling will be to make it easier to assign a value to sell-side research and will result in lower costs for research and consequently, more commission dollars available for best execution. In general, unbundling works in ITG's favor, because it reflects an increased focus on best execution and intensive management of all aspects of trading costs, with the need to make that whole process visible to regulators and clients.

Another favorable trend for ITG is the continued growth of the hedge fund industry. Hedge fund Intelligence projects that assets under management will reach \$2 trillion by 2008, which would be a compound annual growth rate of 53 % since the year 2000. That growth is being driven by institutions who are putting more money into hedge funds in the quest for alpha. ITG added four new hedge fund clients as new clients in the second quarter. Three of the four have over 500 million in assets under management. And importantly for ITG, hedge funds are increasingly spending money on technology. According to the latest hedge funds study by the TABB Group, 43 % of large hedge funds plan to make significant investments to upgrade their trading technology. The study says that the larger a hedge fund becomes the more it needs to take larger positions. It needs to access more liquidity points, interact with execution venues and cut market impact costs. Medium sized hedge funds appear to be the best market to sell order management systems, which they adopt once they reach a certain critical mass in order to help manage their further growth.

On the international front, various studies show that the Europeans had been lagging the US by year or two in terms of trading technology and trading investment, but are now increasing their spending significantly ahead of the implementation of MiFID. MiFID is the new regulatory regime being implemented across the European Union. And the institutions in Europe are now under the same best execution pressures as in the US and being driven to the same need for transaction cost analysis. And they're moving rapidly to program trading as they become increasingly concerned with anonymity and face similar issues of market fragmentation. So the combination of our accelerating product introductions and the European institutions' increased technology spending should result in robust growth for us.

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Our strategy has been aimed squarely at exploiting these trends through aggressive investment in product development and capacity expansion. In fact, we've already seen some increases in adoption of our DMA products and algorithms by US-based fund managers trading in the overseas markets.

Earlier this year, we announced the formation of a new group in our organization called ITG Solutions Network. An important part of its mission is to engineer the integration of a full range of ITG execution systems with the Macgregor order management system. On the trading side of our business we are benefiting tremendously from increased volume coming to ITG's broker-dealer business as a result of the improved connectivity for Macgregor customers into our ITG Algorithms, POSIT and other ITG execution solutions. This part of the equation has exceeded our expectations. As we mentioned earlier, we estimate that over \$12 million of increased revenues on our trading desk are a result of enhanced connectivity through Macgregor. However these volumes are not reported as part of the Solutions Network subsidiary.

We'll be making a significant investment in Macgregor as integration continues with costs picking up in the second half of the year. With that said, we're fully confident that we remain on track with this project and the strategic leap forward that it represents for ITG in the electronic trading sector. During the second quarter we made excellent progress against the milestones we set. We have deployed ITG's algorithmic trading components for the Macgregor system which offer Macgregor users advanced automated execution along with the access to the unique liquidity pools of POSIT, as well as the other ATS's. We have completed the integration of our pre-trade analysis product Logic and our post-trade product, TCA, with the Macgregor order management system. Macgregor OMS users now have seamless access to ITG's pre- and post-trade analytical products for controlling the costs of both domestic and international trading. In addition, we are now connected to all major brokerage firms, delivering a truly broken neutral solution to our clients. We've also completed the advanced integration of the Macgregor order management network to the Pipeline trading system. Users of the Macgregor XIP network will now have access to the full functionalities of the Pipeline application with automatic synchronization between Pipeline and Macgregor XIP. We're on track to link the Macgregor OMS more tightly with our Triton direct market access system in the second half. This phase of integration will provide users of the Macgregor OMS access to the full suite of ITG trading analytics, algorithms and access to sources of liquidity all on a broker neutral basis. And we're working on the next phase of integration which will allow customers to evaluate broker performance and provide enhanced reporting and evaluation tools. On the Plexus side, the Plexus Plan Sponsor reports have been migrated to an electronic form. We're also working to automate the entire Plexus product line to provide our customers with a more timely and efficient way to receive their reports.

Overall, the combination of order management and execution systems is a key part of our competitive strategy. We're pleased with the immediate benefits that ITG Solutions has been delivering to clients this year and will continue to integrate more and more value-added services into one seamless platform. I'd like to emphasize that even as we integrate these products with our existing product offering, ITG Solutions Network is committed to providing broker and vendor neutral solutions. For example, we're now linked and sending orders to virtually all major brokers.

Algorithmic trading continues to be one of the fastest growing and most competitive areas in the trading market. In fact, we now have 17 algorithms in our product suite. We're investing heavily in product development here and have established ITG as one of the recognized leaders in this field. We announced our latest development a few weeks ago with the addition of new list-based algorithms to our suite of algorithmic trading tools. These new list-based algorithms allow our clients to actively manage risk in portfolios of stock during the transaction process. We have designed these list-based algorithms specifically to access some of the fastest growing areas in program trading. These include transition trades, fund cash flows and quantitative rebalances. As with our full suite of algorithmic offerings, our newest products integrate seamlessly with ITG's direct market access products, Triton and Radical. In addition, customers can access our algorithms and send orders to ITG via the Macgregor order management system as well as a wide variety of other order management systems. These algorithms also link to POSIT, so you can see the truly integrated nature of the product line.

A good part of the POSIT growth story is linked to the success of our algorithmic suite. During the quarter, we extended the reach of our DarkServer algorithms to cover even more points of liquidity. Liquidity aggregating algorithms like our DarkServer are the hottest growth area within the algorithm market today. They help manage access to the anonymous liquidity pools that

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traders today see as essential to getting large blocks traded efficiently. It controls the information leakage, it avoids front running, and it minimizes market impact. Now the number of dark pools continues to proliferate and this includes the various public crossing networks such as our own POSIT and the internal crossing systems now run by a number of brokers. This trend towards dark pools is expected to increase as the implementation of Reg NMS and the NYSE's shift to a hybrid model progresses. Our DarkServer algorithms have made ITG one of the most competitive suppliers in this area.

In April, we announced plans to work with Merrill Lynch to create a new global block order crossing service called Block Alert that combines our POSIT technology with Merrill's global distribution network. ITG and Merrill Lynch have worked toward integrating our technologies and organizing the venture. In the second quarter, ITG went live with Block Alert for some of our existing clients. The response has been positive and Block Alert executions are contributing to the growth in the POSIT suite volumes. We'll continue this testing and development phase in the third quarter and expect to scale up to larger volumes later on in the year. Now given Merrill's vast distribution system and liquidity, their partnership in Block Alert could result in significant step up in POSIT volumes.

Now, before closing, let me give you an update on CEO succession. The Board's search committee remains on schedule and has been actively reviewing candidates. We're finding no shortage of very talented people who are interested in joining ITG. We've narrowed our search down to a few candidates and anticipate finalizing our decision during the third quarter. That said, I expect to be active during a significant transition period and as part of my retirement planning, I'll let you know now, I will be diversifying my holdings which are currently concentrated in ITG stock. I'll be doing some over the next year under 10b5-1 program. I want to assure you that my commitment to ITG has not changed. As I indicated, I plan to stay on through the end of my contract and through a transition period after a new CEO is selected.

So to wrap up. Let me point out that industry developments continue to be in our favor in terms of whole new level of focus on best execution in both the US and overseas. 2006 represents the big leap forward in ITG's exploitation of these trends as we make tremendous progress in the integration of our execution and order management systems, the introduction of leading algorithms and dark servers and further development of our direct market access systems is also our strategy. And the investments we are making to develop our products and expand capacity are having very quick payback as our volumes in market share reflect our growing penetration of the institutional and hedge markets in the US and Europe. With that background, we'll be happy to take your questions. So operator, if you could explain the procedure, we can go ahead.

QUESTIONS AND ANSWERS

Operator

Ladies and gentlemen, if you would like to ask a question, please press star-1 on your touch-tone phone. If your question has been answered or you want to withdraw your question, press star-2. Press star-1 to begin. And your first question comes from the line of Daniel Goldberg with Bear, Stearns. Please proceed sir.

Joel Jeffrey - Bear, Stearns & Associates - analyst

Good morning. It's actually Joel Jeffrey sitting in for Daniel.

Unknown

How are you?

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Joel Jeffrey - Bear, Stearns & Associates - analyst

Quick question. Given the recent acquisition of Match Point by the NYSE. Can you guys comment on what you believe ITG's advantages are over exchange-owned crossing systems?

Ray Killian - Investment Technology Group - Chairman, CEO, President

Exchange-owned crossing systems are just that, they're exchange-owned and they have to be brokers sponsored. In other words, brokers have to go out, get the liquidity, and bring it to the exchange system. There has been a long history of these things including the Chicago Match, Lattice, excuse me not Lattice, but Chicago Match. There were several others that were sponsored by Exchanges. The problem from my perspective with that business model is the exchanges don't have the relationship with the end client. It's the broker sponsored system like POSIT is, one that has the relationship with the end client and has always been more effective. It is just another competitive situation. Does that answer your question, Joel?

Joel Jeffrey - Bear, Stearns & Associates - analyst

Yes. Absolutely. Then on the international side. About 28 million in non-U.S revenue, is that based on the location of the customer or what they're actually trading meaning US versus locally-traded securities.

Howard Naphtali - Investment Technology Group - CFO

It's the latter. It's based upon where the execution physically took place.

Joel Jeffrey - Bear, Stearns & Associates - analyst

So they could be trading US Securities?

Howard Naphtali - Investment Technology Group - CFO

Yes. Sorry, if the execution takes place in London, it's a European execution irrespective of whether the client may have been in the US or in Tokyo or wherever. That's the principle that's applied here.

Joel Jeffrey - Bear, Stearns & Associates - analyst

Okay. And then just lastly, on Slide 8 you had 1.4 million in commissions generated by Macgregor and Plexus. What exactly is that?

Howard Naphtali - Investment Technology Group - CFO

Couple of things. You have a revenue share for connectivity to a number of sell site firms where Macgregor is providing access to the sell site firms and consequently getting the revenue share for commissions that they earned by the Macgregor system. That's the primary aspect of it.

Joel Jeffrey - Bear, Stearns & Associates - analyst

Okay. So that's not a business you expect to be growing at all?

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Howard Naphtali - *Investment Technology Group - CFO*

No, [inaudible], it's not material at this stage.

Joel Jeffrey - *Bear, Stearns & Associates - analyst*

Okay. Great. Thanks so much.

Howard Naphtali - *Investment Technology Group - CFO*

Okay

Operator

And your next question comes from the line of Rich Repetto with Sandler O'Neill. Please proceed.

Richard Repetto - *Sandler O'Neill & Partners - analyst*

Hi, Ray.

Ray Killian - *Investment Technology Group - Chairman, CEO, President*

Hi, Rich. How are you doing?

Richard Repetto - *Sandler O'Neill & Partners - analyst*

Ray, you got to bite your tongue on those resource costs going down. We don't want that to happen.

Ray Killian - *Investment Technology Group - Chairman, CEO, President*

Trying to protect you there, Rich.

Richard Repetto - *Sandler O'Neill & Partners - analyst*

Exactly. First question is, when you look at your overall comp went down quarter to quarter and you back in. It sort of looks like Macgregor comp went down dramatically and swung Macgregor to a profit. So if our numbers are correct and comp went down at Macgregor by 2.1 million. I guess the question is, as you shoot, I thought I heard you say \$0.04 accretion in the back half. So you're going to dramatically take down, I would think comp there in the back half and '06; is that correct?

Howard Naphtali - *Investment Technology Group - CFO*

Now there is some reduction in comp quarter to quarter in Macgregor that sure is not that magnitude. And again, there's a lot of new software development that's occurring to take products to the next level as new compliance products are being developed that should be released by the end of this year or early next. In accordance with GAAP, you do capitalize those costs from the point technological feasibility has been established until such time as it's actually released as a revenue generating products

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so that you're actually matching costs with the revenue generation going forward. So that's what transpired where you see the delta on Macgregor [inaudible]. You will see them come back a little higher in the third quarter versus the second.

Richard Repetto - Sandler O'Neill & Partners - analyst

And so the way you get to the \$0.04 accretion then is a combination of other cost end comp? I'm still not--

Howard Naphtali - Investment Technology Group - CFO

Well revenues are part of the equation.

Richard Repetto - Sandler O'Neill & Partners - analyst

Okay. So they were flat quarter to quarter, so you expect them to grow going forward?

Howard Naphtali - Investment Technology Group - CFO

Yes.

Richard Repetto - Sandler O'Neill & Partners - analyst

Okay. Next question, how would you mentioned interesting issue that your costs at 200,000 for the NYSE per month. So you don't hit this 750,000 cap. I know other competitors out there are offering you 60,000 cap like the Nasdaq. Is that one of the alternates you are looking at, seriously?

Howard Naphtali - Investment Technology Group - CFO

Yes, it would be. We're exploring all those alternatives.

Richard Repetto - Sandler O'Neill & Partners - analyst

I would expect that move to be made, every month that goes by could be a Delta, \$150,000, \$140,000.

Howard Naphtali - Investment Technology Group - CFO

There are various issues in these pricing proposals that seek other volume. [inaudible] potentially offset could cost us more money, so you have to look at the overall balance as you people want to do one thing in isolation [inaudible].

Ray Killian - Investment Technology Group - Chairman, CEO, President

You have to be also cognizant of your fiduciary responsibilities to best execution and if the other venues are not attracting NYSE volume, you can't make them move. But it looks so far like NYSE is losing market share, so by de facto they are attracting market volume. So we'll move as aggressively as we can away from a high-cost environment.

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Richard Repetto - Sandler O'Neill & Partners - analyst

Makes sense. And then the last question is, Ray. You talked about the diversification. Any idea on how many shares of diversification we're planning on?

Ray Killian - Investment Technology Group - Chairman, CEO, President

Over the next 12 months, it will be about 300,000 shares of my holdings. I have, just to clarify, I'm closing in on 70 and I've got 70% of my net worth tied up in one stock, so I think it's prudent for me to begin to diversify at this point. Which will leave me with better than half of my holdings at the end of the program over the next year.

Richard Repetto - Sandler O'Neill & Partners - analyst

Understood. Thank you.

Operator

And your next question comes from the line of Mike Vinciguerra with Raymond James & Associates. Please proceed.

Michael Vinciguerra - Raymond James & Associates - analyst

Good morning. Howard, I'm still, I can't quite get my hands around the cost differential. I know you went through a number of different items that affected the comp line. But I was wondering if you could walk through those again? I was writing as quickly as I could. But I was trying to get a sense for the mix shift to the DMA, how much impact did that have on the comp line quarter over quarter? And then when we look forward as far as these development expenses, what line items will those start rolling through? Does it come out of depreciation and amortization, off of capitalized software, how do we think about that?

Howard Naphtali - Investment Technology Group - CFO

Yes is the answer on the latter point and that also triggers some increases in the other G&A I think you're seeing, as a side bar. But you've got a number of things, commissions, revenues actually increased \$8 million versus the trailing quarter. When you look at where our volume growth has come from, obviously we've had an all-time record in POSIT. That is very positive. You've got direct access volumes that over the prior year have actually grown by 75% - 77% and even 19% versus the trailing quarter. The commission pool is lower for something that has a significant lower revenue capture and to some extent a low mark and it's obviously on a different par versus something that has value add as far as trading desk volume or the higher margins on POSIT volume. So you've got an impact coming from there. There was rated in a 1% impact versus the trailing quarter just from people getting FICA limits and we obviously take that expense as it occurs. Smooth that over fourth quarter, so you've got a bucket, and when somebody hits that FICA limit at cost falls off so that's one element of it. And it was about 1% of that comp rate that related to capitalized software. And again, and we told you we were going to add significant amounts of that, we've done that. We exited the quarter with 1,015 people. So we're up 63 people over the end of last year. We now have 347 people in development and that's 34% of our staff and obviously our competitive advantage is about innovation and new products and that's where the investment is going heavily. And as soon as something gets released to the public, it gets amortized running through other G&A and our policies and we've been through in the recent past versus the [inaudible] fairly conservative in the amortization period.

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Michael Vinciguerra - *Raymond James & Associates - analyst*

So if I'm interpreting right, if there's no change in mix next quarter, let's say DMA is the same percentage, would we actually expect to see a higher, slightly higher expense ratio because some of these expenses will start to roll through your adding the expenses from Macgregor and so forth for the development?

Howard Naphtali - *Investment Technology Group - CFO*

Yes. And there'll still more hiring going on, as we haven't hit our hiring goals and to the extent bringing those people in. 21 new people came in June, so we barely have any compensation showing up in the second quarter and you'll get full boat going into the third quarter for starters.

Michael Vinciguerra - *Raymond James & Associates - analyst*

Okay. Thank you. And then just one thing, Ray, on the NASDAQ opportunity in terms of routing. Because, I think they're only charging \$0.02 to route you to the NYSE if there's a better price there. Does that mitigate your worry a little bit about the best execution because if the best price is there you'll still get there knowing you can actually get there cheaper than you can yourself?

Ray Killian - *Investment Technology Group - Chairman, CEO, President*

Yes. It does. It does. Mike, to go back to your comment on the mix here. Remember strategically, a couple years ago we were tremendously exposed in the flow of business as volatility increased in the marketplace. You remember volatility had a negative impact on POSIT in that active players would not stay in POSIT, they would move directly into a active execution mode, because that couldn't wait around for the next POSIT Cross, but what we have done strategically, what we set out to do strategically, was to remove that kind of exposure from our product mix by adding this active component. And that's what you saw happen in the second quarter with the shift in volume mix here. And the volatility pushed people from POSIT a all little bit, now POSIT still had a great quarter, but it pushed them right over into our active products. Which we would not have seen in the past. So that diversification move from a strategic point really worked out quite well. I don't know that you're going to see that kind of volume spike in the third and fourth quarter, so you could see a shift back the other way a little bit.

Michael Vinciguerra - *Raymond James & Associates - analyst*

That's very helpful. Thanks a lot.

Operator

And your next question comes from the line of Richard Herr with KBW. Please proceed.

Richard Herr - *Keefe, Bruyette & Woods - analyst*

Hi. Good morning, guys. Just some detail questions here. Howard, I think in the past, you kind of gave us a road map, if you will, of what to expect in terms of the decline in the rates per share. I'm not sure if we're kind of off that map, now. But I think you've said on an annual basis you forecast between 7% and 10% decline. What should we be thinking about here going forward. Obviously, it's going to be affected by the mix and to raise a point about, you could see some of the mix shift back toward more the matching business. How should we be thinking of rates going forward is what I'm trying to get at.

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Howard Naphtali - *Investment Technology Group - CFO*

That's obviously, a very difficult question. Because the rates of the individual products are fully within the expectations we had and as I quoted some of the percentage growth in the client side business, in answering Mike's question, there's no way anybody's going to realistically expect a 77% year-on-year growth in that product. It's a great thing, the product set. It's as strong as it's ever been. We as those swings and roundabouts go, we can significantly impact rate card. We're not seeing any slippage in July, to the contrary, the rate card actually came up a couple of mills versus June. As you saw, I won't say mix shift coming back, we were in the past but slightly moving. And those of the types of swings roundabout, the overall 10% maybe a point or two more. Is probably a reasonable way of thinking about it. But again, with great degree of caution, the product mix is dictated by our clients and how they want to access liquidity and access the markets which is the beauty and strength of the products side. And it's hard to predict exactly what the market conditions will be and how they'll avail themselves of the products.

Richard Herr - *Keefe, Bruyette & Woods - analyst*

Okay. Maybe on a runway basis on average, maybe in broad terms, can you discuss at all what the mix generally speaking is between the matching business and the DMA? Is it 60/40? Is it 50/50?

Howard Naphtali - *Investment Technology Group - CFO*

Again that's not something we're going to get into. Obviously, we've got record volumes in both POSIT and in client site. And we see some volumes going away from the trading desk and that's just the natural evolution of the marketplace and the prospect.

Richard Herr - *Keefe, Bruyette & Woods - analyst*

Understood. Understood. On the point about the \$11 million one time there in September '06. How should we be thinking about the expense run rate going forward after you recognized that?

Howard Naphtali - *Investment Technology Group - CFO*

No impact.

Richard Herr - *Keefe, Bruyette & Woods - analyst*

Are you recognizing the amortization for your G&A and other line at the moment and should we expect that to trickle down?

Howard Naphtali - *Investment Technology Group - CFO*

The \$11.5 million that's an estimate give or take \$200,000, is really additional purchase price that is contingent consideration. If you recognize when we did the deal in February of 2005, we paid \$90 million plus 1.25% of POSIT revenues on a forward basis just over the next 10 years payable quarterly. So as we've been making those payments they're added as additional purchase price and good will and good will is not amortized unless there's an impairment. So that will not affect the P&L. And we disclosed it obviously, because it's material. And we'll have significant cash flow impact in the third quarter.

Richard Herr - *Keefe, Bruyette & Woods - analyst*

Okay. So, it's cash, so it won't have a GAAP impact?

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Howard Naphtali - *Investment Technology Group - CFO*

It won't have any P&L impact. It will have a GAAP impact, again as you'll see it hanging on the balance sheet as additional good will.

Richard Herr - *Keefe, Bruyette & Woods - analyst*

All right. Thanks for clarifying that. Just lastly, maybe a question for Ray. Just any kind of an update you can give us on some of the beta testing you're doing and where that kind of stands and any kind of thoughts you can give us on where you stand on self clearing? Thanks.

Ray Killian - *Investment Technology Group - Chairman, CEO, President*

Self clearing, we are examining self clearing issues, but you have to bear in mind, that self clearing is not an ongoing business, but an expense controlled factor. It could be quite significant and we're definitely going to move in that direction. On options, execution is in fact occurring now in a small way. And we're looking to upgrade some of the technology in that regard. I don't consider that a huge opportunity for us, not as much as I do the DMA and the integrative routing capabilities of the firm. Good part of the growth story has been, and the growth story in POSIT has been because of the tight integration between all of us servers. It always gets into the DarkServer which routed out to different pools of liquidity. Hits POSIT now and stays in the system. We control that order for much longer periods of time now. That's another factor that drove active trading in this last quarter for us.

Richard Herr - *Keefe, Bruyette & Woods - analyst*

Ray, do you think the SEC is looking for a pilot for options for decimalization? Do you think as that market moves towards decimalization and possibly you introduce the algorithmic trading community to more and more trading options, do you think there's an opportunity for ITG there?

Ray Killian - *Investment Technology Group - Chairman, CEO, President*

That's going to be an interesting phenomenon if they go to decimal trading and all of the related expirations, it could be a very complex problem for people to handle, which is great for the algorithmic side.

Richard Herr - *Keefe, Bruyette & Woods - analyst*

Okay. Thanks, guys.

Operator

And your next question comes from the line of Ken Worthington with JP Morgan. Please proceed.

Ken Worthington - *JPMorgan - analyst*

Hi. Good morning. First on compensation. Given your comments about increased investment in Plexus and Macgregor this quarter and then in prior quarters about investments elsewhere. What kind of magnitude and maybe you can help us with the

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timing of how we should expect compensation to change over the coming quarters? Are the investments, are they bit are they small? Is it a couple million, is it more? How [inaudible] previous comments?

Howard Naphtali - *Investment Technology Group - CFO*

The Plexus/Macgregor area it's going to start to show up in the latter part of the third quarter. And relative to those businesses, they're not insignificant. But again, consistent with the way we view the business overall, we're going to invest in areas that we think will bring long-term returns and obviously all products set and when you get into the OMS business our support infrastructure can be a differentiating factor and we need to move it to best in class in that area.

Ken Worthington - *JPMorgan - analyst*

Okay. And then on your prior comments in previous quarters about investing in the business. You said you hired 21 new people in June. What kind of hiring do you have left through the end of the year?

Howard Naphtali - *Investment Technology Group - CFO*

Again, it's probably 40 or so open slots, whether or not, when they will be filled, is hard to gauge.

Ken Worthington - *JPMorgan - analyst*

Okay. Thank you. And then with regard to competition. Can you talk about the recent venture between Bank of New York and Eze Castle. Aside from this being a validation of your purchase of Macgregor, it also seems like this venture probably more fully competes with ITG than most any other firm. So I guess, first of all, what kind of opportunities do you see to win market-share from this venture, given the inevitable disruptions that these combinations cause. And where is ITG potentially vulnerable? Are there holes that you feel you have to close?

Ray Killian - *Investment Technology Group - Chairman, CEO, President*

We've been competing with Bank of New York for the past four or five years with the exception of the ownership of Eze Castle. It's a validation of our strategy to pick up the OMS system, that's for sure, and if the validation of our business model I think the way they're cobbling this thing together. I think, basically, the differentiator here, quite frankly, is that our product suite is a proprietary product suite with a lot of intellectual capacity to it. And its quality is beyond refute. We don't bump into them head-to-head in the algorithmic space at all. We don't bump into them in the electronic front-ends at all. We're bumping into some of the bigger firms there, but not Bank of New York. I don't think it's any more of a threat this week than was last week.

Ken Worthington - *JPMorgan - analyst*

Perfect. That's helpful. And then can you give us a number of installs you had for Triton and Radical during the quarter?

Howard Naphtali - *Investment Technology Group - CFO*

Yes. I can give you in Triton, we had 165 sites at the end of the quarter, Radical we had 129. For Triton, that would be about 24 installs in the quarter.

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Ken Worthington - JPMorgan - analyst

Okay. Thank you very much.

Operator

And your next question is a follow-up with Mike Vinciguerra with Raymond James & Associates. Please proceed.

Michael Vinciguerra - Raymond James & Associates - analyst

Thanks. I just wanted to ask if you guys to give a general mix between listed shares traded versus NASDAQ trading so we can kind of gauge that?

Ray Killian - Investment Technology Group - Chairman, CEO, President

Still running roughly 65/35.

Michael Vinciguerra - Raymond James & Associates - analyst

Listed to NASDAQ?

Ray Killian - Investment Technology Group - Chairman, CEO, President

Listed to NASDAQ. Yes.

Michael Vinciguerra - Raymond James & Associates - analyst

Great. That's all I wanted.

Operator

This concludes the Q&A portion of the call. I would now like to turn the call back over to management for closing remarks.

Ray Killian - Investment Technology Group - Chairman, CEO, President

Okay. Well, thanks everybody for attending. And we'll be available for follow-up calls, if anybody has any questions. Thank you, Operator.

Operator

This concludes the presentation. You may all now disconnect. Have a Good Day.

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