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FXCM - Q3 2015 FXCM Inc Earnings Call

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Operator

Chris Reddy *Lazard Capital Markets - Analyst*

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PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the FXCM Inc.'s Third Quarter Earnings Conference Call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions). As a reminder, this call is being recorded.

I would now like to introduce your host for today's conference. Head of Investor Relations, Jaclyn Klein. Please go ahead, ma'am.

Jaclyn Klein - *FXCM, Inc. - VP, Corporate Communiations and IR*

Thanks, operator. Good afternoon and thank you for joining us for the FXCM Inc.'s third quarter 2015 earnings conference call. Joining me today are Drew Niv, FXCM's Chief Executive Officer; and Robert Lande, our Chief Financial Officer. A live audio webcast, a copy of FXCM's earnings release, which was sent earlier this afternoon and presentation slides used during the conference call are all available at www.fxcm.com under the Investor Relations tab. A replay of this conference call will also be available later tonight on our website.

Before I turn the call over to Robert, I would like to remind everyone that in today's remarks, we will refer to certain non-GAAP financial measures, included adjusted EBITDA. These measures should not be considered in isolation from or as a substitute for measures prepared in accordance with Generally Accepted Accounting Principles. Reconciliations of these non-GAAP financial measures to the most comparable measures calculated and presented in accordance with GAAP are available in the earnings release on the Investor Relations portion of our website. As usual, this call is intended for investors and analysts and may not be reproduced in the media in whole or in part without the expressed written consent of FXCM.

Before we begin, we would like to remind everyone that the remarks and responses to your questions that we provide today may contain forward-looking statements. These statements do not guarantee future performance and undue reliance should not be placed on them. These statements are based on current expectations of management and involve inherent risk and uncertainties that could cause actual results to differ materially from those [indicated] in any forward-looking statements, including risk associated with the events that took place in the currency markets on January 15, 2015, and the subsequent financing agreement as well as the cyber security incident that was reported in a press release on October 1, 2015. And those identified in the Risk Factors section of our Annual Report on Form 10-K filed with the SEC and available on our website as such factors may be updated from time to time in our SEC filings. FXCM assumes no obligation to update any forward-looking statements.

With that, I'd like to turn the call over to CFO, Robert Lande.

Robert Lande - *FXCM, Inc. - CFO*

Thank you, Jaclyn. Turning to slide 3, highlights for the quarter, net revenues from continuing operations were $59.6 million, down 1.5% from last quarter. Our net income from continuing and discontinued operations attributable to FXCM Inc. was $73.6 million or $13.86 a share. As of the past two quarters, it's worth noting that our net income includes a number of non-cash items, in this case, this quarter $137.6 million non-cash gain on the Leucadia Letter Agreement and $29 million of various non-cash expenses. A bit easier to follow. Looking through these non-cash items, we had adjusted EBITDA of $5.2 million versus $5.9 million, Q2 of 2015.

Looking at just the operations of our continuing operations, which are in essence our retail FX businesses based in the US, UK and Australia, we had slightly better revenue capture of $56 per million from last quarter, but it's still not where we would like to see it and it was due to the challenging CFD market that was in June continued through July. Although one full month may not reflect the entire quarter, I will say that October and the beginning of November are improved from these levels. Also, Drew will address later in the presentation the Enhanced Index CFDs technology launched this past Monday, which was one of the more important growth drivers for FXCM this year and should hopefully reduce some of the volatility in CFD revenue capture. Lastly, our total retail volume of $972 billion was down 3% from Q2 and is a reflection that volatility was also down in Q3 from Q2. Average CVIX in the quarter was 9.9 versus 10.1 in Q2, 2015.

Turning to slide 4, our cash position remains strong. Operating cash in our continuing operations was $210 million at September 30 as compared to $208 million at June 30, an increase of $2 million. Overall combined cash in continuing and discontinued operations was $254 million. Likewise, our regulatory capital position remains strong with a surplus of $85 million in our continuing and discontinued operations.

Turning to slide 5, our retail average daily volume of $14.7 billion was down from Q3 due to the lower volatility. Our retail dollars per million, as I mentioned, were up from Q2, but still depressed due to the performance of our CFD business. Retail DARTs increased by 32,000 a day to 563,000 and there were no major changes in the volume mix from the previous quarters. Drew will talk in a couple of slides about the geographic mix of our business and how it has now evolved, given our disposals of our Japanese and Hong Kong retail FX businesses.

Turning to slide 6, this table presents our adjusted revenues, expenses and EBITDA for this quarter versus Q3 2014 from continuing and discontinued operations. I do not propose going through the comparison to last year given all that has happened post SNB events of January 15, but we'll point out that our EBITDA shortfall of $1.3 million in this quarter from continuing operations was better than the $2.8 million shortfall last quarter. EBITDA from discontinued operations of $6.5 million was worse than last quarter's $8.7 million, primarily due to V3, which had a particularly good Q2. Although this was partially offset in Q3 by Lucid which had a stronger quarter and generated $6.4 million in EBITDA versus $4.5 million in Q2 2015.

Slide 7 presents our operating expenses on an adjusted basis for the past three quarters. And I think you can see a positive story here with total expenses going down by $3 million or so each quarter from Q1 2015. You can see that advertising has been increasing each quarter, but overall, you are seeing savings in referring broker fees, communication and technology, trading costs and compensation.

Slide 8 is our balance sheet, versus the end of last quarter, no major changes really. Cash and cash equivalents is down from $217 million to $186 million. But as I pointed out on slide 4 when you include cash we have on deposit at brokers as well as P&L in transit between us and our brokers, which shows up in the Due From and Due To Brokers line, total operating cash from continuing operations increased slightly in the quarter from $208 million to $210 million. I'm happy to address any questions you may have at the end of the presentation.

And with that, I will turn the call over to Drew.

Drew Niv - *FXCM, Inc. - CEO*

Thank you, Robert. I like to provide an update on asset sales where we are in a process of repaying the Leucadia debt. With the completion of the sale of FXCM Hong Kong, we have now repaid $115 million of the principal to Leucadia with $195 million remaining. We have recently updated guidance stating that the asset sale process is still ahead of schedule. But we are targeting to have all the debt repaid by first quarter of 2016. This is slightly longer than the deadline we gave last time which we thought would be the end of the year, but we still think Q1 is a very doable day. We want to have the debt repaid as soon as possible. We understand the investor concerns and frustrations. But when asset sales are being negotiated, obstacles may occur to which we have no control. We have an entire team working tirelessly to complete the asset sales, so the outstanding debt can be fully satisfied. As soon as we have any agreements signed and can announce another completed asset sale, we will.

I would like to mention that somewhat related to this topic, a few weeks ago in Leucadia's Investor Day on October 8, the CEO of Leucadia specifically said that they're very happy with their investment and view this as a long-term relationship and a chance to build something special and that Leucadia is partnering with existing management team and expects to be working with the management team for years to come.

We realize that while we have this debt, it's hard for our largest client to feel comfortable depositing and keeping their once-larger balances with FXCM. We've seen that in our client equity and revenue per million numbers. We're optimistic than once the debt has been fully paid back, their confidence in the firm will return and our evidence shows that most of our large clients did not close their accounts. But really just reduced the amount of client balances and as soon as they feel more comfortable with the optics, the firm, we believe in those balances will return.

That being said, if you take a look at Slide 10, it displays data compiled by third-party research site, Investment Trends. They surveyed over 11,000 active traders in the US alone and published their results very recently. As you can see from the results, efficacy and resilience in brand power still outpace our competitors despite the reputational damage we endured due to the January 14 event. Now, this Investment Trends, they do the survey in most of the geographies that we operate in, specifically, in Europe and Australia and in some parts of Asia. We thought it would be good to highlight the US Investment Trends Report specifically because the US is where we suffered the biggest reputational damage, it's where the publicity of the SNB event was the highest. And it's also where most importantly, our customers have the least amount of client funds protections. To remind everyone, in our UK entity where most of our global clients reside. Our clients have 50,000 pounds insurance from the government, as well as segregated fund protection, which means they're prioritizing bankruptcy. In the US, customers don't enjoy any of those two. So, the US is where you would think that majority of the damage would come and that has obviously been the case. But as you can see from slide 10, this is something where we have held up pretty well. Our market share is still 33%. While that's down 5% from last year, that is still 17% higher than our nearest competitor. The only place where we underperformed is during a survey period of this is post SNB, that we attracted less than our market share in new investors. But in terms of customers switching from broker-to-broker or essentially experienced customers therefore, our customers are dormant and reactivating FXCM slightly outperformed its actual market share, which is very hard to do for a market leader and that makes us very confident, not only in the strength of our offering for our clients, our clients can see despite the optics the make our stock look very bad, they still have confidence in the product offering and how more competitive we are with our competitors.

As you can see, the brand resilience, we won first place in the branding category and most of the categories, we are very proud of this accomplishment. Again, survey period as you can see in the top of the slide. So May 5 to June, 21, 2015, a very, very challenging phase for us. And I would like to point out that as of the last few months as we increased and we launched our Dealing Desk for small accounts, we have increased the number of new accounts and believe that we have kind of closed the gap in underperformance on getting new investors and should see our market share rise again in the next survey that will be done next year.

And I would like to also add that this is again our hardest hit geography in the United States and this is something that we take with a lot of pride that we're still able to keep the resiliency here as much as we can.

Turning to slide 11, want to discuss an important initiative we just announced in our CFD platform which we believe will be a significant driver for future growth. This is our first major initiative on the CFD side to really start ramping up our offering and to begin gaining market share from our overseas competition.

On October 26, we launched globally except in the US where CFDs are not allowed our enhanced index CFD technology where we will be able to instantaneously hedge positions with the futures market. A lot of changes we've done on the back end, but the clients will definitely feel and reap the benefits. We will have the ability to better manage our CFD index flow. These changes will significantly reduce our market risk and allow us to entice aggressive traders to utilize our platform.

A significant segment of the market in this segment that are compares of no interest in targeting. API users, scalpers and news traders are often removed from other platforms or have to fight against restrictions in placing trades especially stops and limits. Now they can come to FXCM and trade freely. It's a unique competitive advantage exclusive to FXCM. Also, we can offer tighter spreads at small trade sizes and appeal to the most attractive clients out there and those who are the most frequent traders and those who are the most aggressive customers. We believe that this will also increase our revenue per million, both in better hedging our books as well as increased volume on the platform for sophisticated trades.

Moving to slide 12, if you take a look at the global FXCM footprint, we remain well diversified in servicing the global market. 31% of our current volume comes from regions where FX and indexed CFDs are very popular, 25% of our current volume is coming from regions where only FX is allowed and we have another 31% of our volume come from regions where FX commodity CFDs are most attractive. We know where we need to target specific products. We continue to grow our core business and this map kind of gives you an update of not just geographic concentration of us. Still the business is very geographically diversified as well as, again, the majority of our flows. Majority of our volume is coming from countries where we can market both FX and CFDs. I believe this will have a fairly large upside in the future.

Moving to slide 13, you will see there our retail metrics have remained consistent. Remember last year in October of 2014, FXCM reported record volume for the firm and we also had just introduced our much lower commission price. This year, [our] total metrics show that we continue to grow our core account base, even with the sale of two retail subsidiaries that we have stabilized our business and I believe with all our new initiatives continue to grow these metrics to the levels we saw prior to January 15.

Now October, as you can see from the metrics came in, the headline numbers in ADV, trading volume came a little bit better than September, but we can also say that our dollars per million improved slightly as well and that's improved as well, and therefore we expect financial performance in October and in the early part of November to outpace that of Q3.

Turning to slide 14, just to summarize, I think FXCM today remains in a very strong competitive and financial position. Although, obviously, for those of you looking just at the stock, it's hard to see. It's why we constantly present the balance sheet and see that, as a company, FXCM still has a very strong balance sheet, a very simple balance sheet, which is one of the core strengths of it is that this is a not complicated, very cash heavy balance sheet. We have rolled out two of our products that we meant to roll out this year to enhance the indexed CFDs which we just did recently and are dealing this product for more clients and dealing this product right now does about 13% of our retail volume versus 7% in Q2. As we've kind of gave guidance before, we don't see this number exceeding 20% anytime soon, but it is something that should grow from 13% and that has a positive effect on dollar per million as well on attracting new accounts, as before we were discouraging smaller accounts due to them not being profitable on our No Dealing Disk offering but is a Dealing Desk. They are profitable. As I said before, we have solid financial position and we believe that this is something that is not -- obviously as everybody knows, is not reflected in the stock, but we have $254 million in operating cash, $85 million in regulatory capital surplus. And I think one of the things that is often misunderstood by many of the non-institutional investors that we do have is that the software presents today some perception of what and a bet on what do shareholders still own of the Company and this is something that we will not know for sure until we discussed that with Leucadia plus paying the debt back sometime next year. But for our customers, as a company, the Company has a very solid financial footing and we believe that that will be reflected once we fixed the optics of the stock next year is something that we think will attract a lot more business and give us a fairly bright road ahead. So while we cannot tell you at this time or not close to yet to being able to give you guidance to shareholders as to what is their portion going forward of FXCM and market price continues to be a good indication why that possibly is. That is not the case for our customers and therefore the business is in a very strong financial position.

With that, operator, we'll take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Chris Reddy, Lazard.

Chris Reddy - *Lazard Capital Markets - Analyst*

Yes, guys, thanks for your time. I guess a couple of a multi-part question. You're doing about $25 million of EBITDA and it's principally all in the discontinued operations. What's the plan and what's the forecast that you see the continuing operations being able to generate, once you get past this year and all these unusual items go away and then to the optics that you had mentioned, you repay this debt. I mean the current agreement you have with Leucadia allows them to force a sale and it's somewhat written in stone how the value gets distributed. You were alluding to something about you talked to post the debt paydown. Is there some possibility that the deal has changed and obviously, if that were to occur, would enhance the value to you and probably garner more customers? So just wonder if you could speak to those.

Drew Niv - *FXCM, Inc. - CEO*

I think that, let me take the first one first. There is a significant amount of corporate overhead and significant amount of expenses that we have essentially having a lot of -- for lack of a better work different subsidiaries in different businesses. As we simplify that operation by selling off those institutional businesses, overhead for the core company essentially declines fairly substantially. You've seen some of that in the slide that Robert went through, but there is significantly more of that to come over next year or so. There is also the issue where I think the easiest way to describe the damage done to FXCM core business is essentially that the upper crust of our client base, [Brian], the top or so 10% is obviously where a disproportionate amount of our profits used to come from before SNB. This is the part that obviously was most impacted in terms of reducing the imbalances and therefore the volumes that they do with us. So this largely doesn't impact cost and really just impact revenues. We retained the bulk of those clients, some have left, but most are not. They just reduced the amount of balances they have with us, which has a significant negative effect on revenues. We believe when that comes back that, that will have a meaningfully large effect on us to the positive. We also continue to the grow the business and improvements we're making to the business, all R&D here and other things are still on schedule even though prior there everything was kind of stunted in the last six months, (inaudible) SNB that's no longer the case. And I think we're now no longer behind schedule on most of the stuff we're going to introduce.

We are very optimistic that continuing operations will be a fairly profitable piece of the firm going forward. Obviously, the pieces we are selling are very valuable. We bought those for a reason. They have improved -- one of the things, for example, we haven't mentioned a month of October was a record month for V3, for example and so they had a spectacular performance recently. So they had a good first two quarters, not a great Q3 but a spectacular October. So hopefully that continues in the rest of Q4. This is a business that's very strong. Lucid is still a fairly strong business. Even in a very tough environment, it's holding up better than many of its peers and these are assets that we think we'll be able to monetize a quite significant amount of money and we'll be able to essentially use those funds to repay the debt to Leucadia. So that's the first question.

The second question is really just -- when Leucadia said in their annual meeting that they will be simplifying the structure going forward for FXCM, as I said in kind of my remarks, we are not going to be able to give any guidance yet on what that is and I think I don't want to kind of give hope at this stage that it's going to improve the deal to shareholders, it will certainly make the Company more appealing to its customers. We can certainly say that that's a goal, the outcome of negotiations as to how we split the pie, if you will. Those negotiations haven't even started and will not start really until we pay the debt back and so I don't want to give guidance and say that that's something to expect, but I can tell you that we're focusing right now on putting the business and getting the business in the best shape that it can and repaying the debt as fast as we can. And those two things, we think we are delivering very solidly on. The other stuff we're going to have to see when the time comes.

Operator

Kevin Starke, CRT Capital.

Kevin Starke - *CRT Capital - Analyst*

Hi, this is probably a little bit of a refinement on the previous question, but, you show in the slight deck some progress on cost reduction. Compensation though really isn't moving lower and I'm wondering if you think it needs to in light of your shrinking business. And then, you have shown some downward progress in referral fees, but I'm wondering, is there something that you give up when you -- are opportunities lost as a result of that. Thanks.

Drew Niv - *FXCM, Inc. - CEO*

Let me do the second one first if you don't mind. So we are deliberately one of our ongoing efforts to essentially make the firm simpler, more nimble, more profitable in the long run is to reduce its reliance on introducing brokers and the like and have more organic growth to it. There is definitely some opportunity lost in doing this. But it's far outweighed by the fact that given our new -- this is an initiative that we started before SNB and is something that we've been working on for a while. We accelerated it when we essentially cut client fees fairly significantly in the fall of 2014. Initially in the impacted areas where we cut those fees, we saw 70% rise in volume, so it was very encouraging. If you want to go back and look at our Q4 2014 presentation, I think obviously that progress was cut short by SNB, but this is something we feel very strongly about, specifically in light of the current regulatory climate around the world and other things that just make those relationships just much more burdensome than they were. And I think this is something that is very necessary for the business. There certainly is not, I don't want to say that, we give up some stuff but overall it's a very positive move for us. And I will say this, obviously, given our situation, we are very conscientious about try not to give up any good revenues and we are fighting for every dollar as hard as we can and this is something that we --.despite all that, we're still giving those things up.

On the second front on compensation, I'd say though I think we announced a while back that we've put together in the continuing operations, our retention package for the top 150 or so employees for the firm for 2015 and 2016 to essentially preserve the human capital of the firm in its core business and this is something where we gave updates recently that we have done a pretty good job at retaining the very, very large majority of those who were seeking to retain. And we have had very, very few [defections] and this is something that generally is not experienced by businesses in our situation and all of the affected employees have had -- have been employees, most of them been employees at the firm for a decade or so, have had a lot of their wealth indeed in the equity of the firm. So this is [partly] to compensate for something like that. These packages are temporary until a deal with Leucadia can be worked out for longer-term benefit of all of these people. So some of this we've actually had a pretty meaningful reduction in compensation with the exception of these retention packages. If you look at our retention packages, they will expire in December of 2016 and I think that will be very clearly shown and we'll obviously make a fairly big impact to expenses post that period.

Kevin Starke - *CRT Capital - Analyst*

Okay. You are alluding to a deal with Leucadia and I'm kind of wondering what that means.

Drew Niv - *FXCM, Inc. - CEO*

As I said, this is I think too early at this point to say and I don't want to essentially, one of the things obviously in these situations is sort of like the asset sales is some things we can't discuss. This one is not -- as I said, we haven't even started and it's something I do not want to give people hold to until it's something that we actually get to and do, but this is something that will materially improve essentially, the piece of the pie that the shareholders own of the Company. Given the deal with Leucadia, I can tell you, as we said before and what Leucadia said is they want to be long-term partners. What percentage that will be at the end and what percentage the shareholders will be at the end, the economics of the firm, we can't talk about at this time because we honestly don't know.

Kevin Starke - *CRT Capital - Analyst*

Your dollars per million trade is traveling in the 50s now, used to be in the 90s, games is in the 90s but they kind of have a different business mix than you. Your business has obviously fundamentally changed. So I'm wondering what you're thinking, what is the -- in this new reality that you face, are 90s something that you kind of have to give up on and set a target lower or what should we be thinking for what your goal is?

Drew Niv - *FXCM, Inc. - CEO*

So we kind of break the business down into sort of two pieces. There is an agency component primarily in FX and there is a principal component in the new Dealing Desk offering for small accounts in FX and it's in the principal offering in CFD. So in the agency FX business, we made a deliberate move in the fall of 2014 to discount that business and to go after and to very aggressively switch to a more organic mix and to more aggressively switch to a higher-end client by offering down a much lower commission and therefore something that we went from being -- can review it in the Q4, 2014 presentation, we went from being one of the more expensive brokers in the retail FX commission wise to one of the least expensive. We think this has played a big role post SNB and now are retaining the bulk of our clients. So that is a deliberate move that took the agency FX business essentially from the 90s to the 50s. In the principal business, the dollars per million are a little bit higher, and they do fluctuate, they are not -- it's not our commissions, that business is still aiming to be fairly above that number. I will say that, that is something that you can see in every quarter, we report that number, we aim to raise it as the mix of principal business increases. Are we going to be at 90 plus? At this stage, it doesn't look like it, again some of that is deliberate, we are pricing lower and some of that is the reality. I will say that probably the easiest way to look at it is the more markets have been -- especially in FX markets have been fairly subdued even while other asset classes have been moving a lot more. If FX volatility returns, those dollars per million do increase fairly substantially and obviously the more wobbly markets in general get the dollars per million do tend to increase fairly dramatically. But assuming that this current market conditions stay the same and assuming that we kind of maintain the same policy, I would think that the dollars per million are going to be creeping higher slowly, but are not going to go back to the [norms].

Kevin Starke - *CRT Capital - Analyst*

Okay. I got one more for you. This one is maybe a little harder to answer. You're a futures commission merchant, so you probably have some four desegregated funds. You're telling us that part of the reason why your institutional customers are not coming back is that they know that they don't have protection and their ForEx accounts, in the event of a bankruptcy, people learned from what happened in Refco and to some extent in MF. Have you investigated legally ways that you could approximate for desegregation for institutional ForEx customers like holding money in separate trusts or something like that so that [they could get these] people back.

Drew Niv - *FXCM, Inc. - CEO*

Let me give you this kind of the clarification on this. So overseas where the bulk of our business is we do have segregated funds in the US. In the US, we are what is called an RFED. So a retail foreign exchange dealer, which is a subset of an SNB. And the RFED license gain is an RFED, right, there are a few others that very few of those RFEDs left given the regulation in the sector. But the RFED, us primarily, is essentially a subset of the FXCM that primarily deals with our retail FX. So our customers, retail FX customers are not covered under the segregation rules and therefore in the United States do not have segregated funds protection, it's very deliberately from the regulator wanted to separate futures and FX. Ask your Congressmen why, but this is not (inaudible) can be remedied and even though Dodd-Frank has given a swap dealer client seg protection, it is still something that has not come to retail FX over the counter clients. Again, one of the things that I think we've recovered in prior, if you were listening to some of our tirades against regulation in the last few years is that essentially, we used to have 47 RFEDs in the United States about six years ago. There is effectively three today. It's not a huge mystery why that is the case. Obviously, the regulatory environment is extraordinarily strict, extraordinarily tough, yet at the same time, does not offer any benefits to the customers of any practical value in terms of customer funds protection.

This is a mystery the other regulators have apparently solved, the US regulators have not. But that's not something that we have tried for years to move that one. That's not something that we foresee moving to zero action in this regard and the regulators adamant against it. So that's not something we see happening [against that]. We dealt with this situation for years. So we've had large customers in the US despite all that. I think at this point in time, customers are confusing the status of this market capitalization and the price of a stock with the balance sheet and the solvency of the firm I'm not appreciating the fact that essentially the value of the stock reflect I guess on the west shareholder percentage versus would be a percentage of the economics are not a factor of what the company's work itself and so not really a credit risk, a good reflection of credit risk to the customer. But this is something that obviously is too complicated for most people to kind of take in and that's where we are.

Kevin Starke - *CRT Capital - Analyst*

I understand. Thanks for answering my questions.

Drew Niv - *FXCM, Inc. - CEO*

Sure.

Operator

Thank you. At this time, I'm showing no further questions. I'll now turn the call back to Jaclyn Klein for any further remarks.

Jaclyn Klein - *FXCM, Inc. - VP, Corporate Communiations and IR*

On behalf of Drew, Robert and everyone here at FXCM, I'd like to thank you for joining us this evening and we look forward to speaking with you next quarter. Thanks, operator.

Operator

Ladies and gentlemen, thank you for participating. This does conclude the program and you may all disconnect. Everyone, have a great day.
