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FXCM - Q2 2015 FXCM Inc Earnings Call

EVENT DATE/TIME: AUGUST 06, 2015 / 8:45PM GMT





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## CORPORATE PARTICIPANTS

**Jaclyn Klein** *FXCM Inc. - VP, Corporate Communications & IR*

**Robert Lande** *FXCM Inc. - CFO*

**Drew Niv** *FXCM Inc. - CEO*

## CONFERENCE CALL PARTICIPANTS

**Operator**

**Lee Jagoda** *CJS Securities - Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen and welcome to the FXCM Second Quarter 2015 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 follow at that time. (Operator Instructions). As a reminder, this conference is being recorded.

I will now turn the call over to your host, Jaclyn Klein. Please go ahead.

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**Jaclyn Klein** - *FXCM Inc. - VP, Corporate Communications & IR*

Thanks, operator. Good afternoon and thank you for joining us.

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, including 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 risks and uncertainties that could cause actual results to differ materially from those indicated in any forward-looking statements, including risks associated with the events that took place in the currency markets on January 15, 2015 and the subsequent financing agreement, as well as 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.

And with that, I'd like to turn the call over to our CFO, Robert Lande.

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**Robert Lande** - *FXCM Inc. - CFO*

Thank you, Jaclyn. Good afternoon. Thank you for joining us today.

Turning to slide 3. In the second quarter, we had revenues from continuing operations of $60.5 million and a net loss of $95.8 million or $1.97 per diluted share. As I went through last call in discussing the accounting around the Leucadia transaction, there are a number of non-cash items in our results. And for this quarter, non-cash items were $90 million of the $95.8 million loss.

EBITDA from continuing operations was $5.9 million. Revenue per million was $54 per million, below our recent range but very specific to conditions and various factors in the CFD market for June. Drew will talk more about this in a little bit during his remarks.

Q2 was a strong quarter of volume in our retail business from continuing operations with $1 trillion of total volume, up 7% sequentially from last quarter and up 30% from Q2 of last year. In a nice ray of sunshine was our initiative to move small clients to our dealing desk model, dealing desk volume has now reached 10% of total retail volume in June. Since launching our dealing desk initiative, we have been averaging in the $90s per million versus $50 per million to $60 per million on our [EEE] model for FX. So as dealing desk volume grows, it portends well for future increases in our revenue per million.

Turning to slide 4. FXCM remains in solid financial position with $272 million of our own cash. This is down from Q1 2015, but a significant part of that is that FXCM Japan was sold just after March 31 and so all its cash gets removed from the calculation. Our customer equity grew $68 million or 10% from last quarter. $47 million of that increase was due to our acquisition of the accounts from Citi FX and the remainder was organic. I think it is a strong vote of confidence that Citibank chose FXCM to put its customers with when it decided to exit the business. Finally, our regulatory capital position and surplus is as strong as it has been in recent years. We now have $71 million of regulatory capital requirements and regulatory capital of $188 million in our regulated entity, mainly the US, UK and Australia that has a surplus of $117 million.

Turning to slide 5, you can see some of the key metrics of our business. On the top left is the average daily volume of our retail business, which you can see was $15.9 billion a day, with most of that coming from continuing operations, as only now our Hong Kong subsidiary whose sale is pending regulatory approval is in discontinued operations as it regards our retail FX business. To the right is our revenue per million on the retail side, which I mentioned was $54 per million in the quarter and which Drew will talk a bit about in a few minutes. Bottom left, our retail daily average revenue trades at 542,000 a day and Q2 remains robust. And looking at the bottom right graph, no major changes in our volume mix from last quarter with Asia and EMEA representing each around a third of our volume, US around 23% of our volume and the rest of world around 10%.

Turning to slide 6. This table presents combined continuing and discontinued operations for Q2 2015 versus Q2 2014 on an adjusted basis. Focusing on the middle shaded column, adjusted continuing operations, you can see that this quarter, we generated $60.5 million in revenues versus $75.1 million this time last year, really a function of the revenue per million shortfall this quarter. Operating expenses from continuing operations for this quarter of $63.3 million compare favorably with the same quarter last year of $66.8 million with higher compensation and benefits, a result primarily of retention plans we put into place this year, more than offset by lower referring broker fees, advertising and trading costs. And total EBITDA from continuing operations was a loss of $2.8 million this quarter versus positive $8.2 million last quarter.

Looking at discontinued operations, for the quarter, our discontinued operations generated $8.7 million in EBITDA versus $5.2 million the same quarter last year. And even more impressive performance given that last year, you would have had FXCM Japan in discontinued operations versus being excluded this past quarter, having been sold at the beginning of the quarter. Notably, V3 had a solid quarter, doing $3.8 million in EBITDA and Lucid did $5.2 million in EBITDA portending well, as you know we are in the process of trying to sell both of those businesses.

Turning to slide 7, I thought I would touch briefly and highlight operating expenses on a sequential basis rather than year-over-year. As you can see from the table, total operating expenses were down $3.1 million or 5% from the quarter before, with lower compensation and benefits primarily from reduced headcount and lowering referred broker fees partially offset by higher advertising, which was exceptionally well in the first quarter.

Slide 8 presents our balance sheet. [You remember our call] from the previous quarter's call that all of our discontinued operations, Lucid, V3, Hong Kong and in the case of March 31 Japan, their balance sheets are collapsed into two lines with all assets of theirs including operating cash showing up in current assets held for sale and all liabilities showing up in current liabilities held for sale. And that really represented the change in the balance sheet as Japan came out after March 31 and caused the changes in those lines together with the revaluation of Leucadia letter agreement. [Seeing through] the current assets held for sale line total operating cash at FXCM, as I already pointed out a few slides back, actually was $273 million.

Finally, before handing things over to Drew, let me turn to slide 9 and run through operating metrics for July. Industry-wide July was a notably quieter month and actually we performed in line or outperformed many of our peers who have reported already. Retail customer trading volume was $317 billion in July, 13% lower than the previous month. ADV came in at $13.8 billion per day. Active accounts increased 2,200 to 180,000 accounts. And retail DARTs declined 9% to 533,000 trades a day. On the institutional side, volume came in at $205 billion, down 10% from June and ADV was $8.9 million. So in all, July was a more subdued month reflecting the moderation in volatility.

And with that, I would like to now turn things over to Drew to talk a bit about our strategy and how we are doing in the execution of it.

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**Drew Niv** - *FXCM Inc. - CEO*

Thank you, Robert.

I would like to touch on to page next slide -- just to touch on these two subjects and the first one is just give you a preview on asset sales.

So slide 10, update on asset sales. As you can see from the table, FXCM Japan has been sold and together with other proceeds, we've already paid about $81 million of $310 million we owe to Leucadia. The next one up is Hong Kong where the sale has been completed and we announced it before, we're just waiting for regulatory approval. And we believe that according to the regulators, we should be receiving that approval any day and we will get the proceeds at that point, didn't make it in time for this call, but we think that's very much imminent, and that would take repayment over 100. We believe we are getting very close on the others given the sensitive nature of auctions and asset sales and the in the nature that we are also a public company. We cannot announce until things are done, but we are at this stage feeling increasingly confident that before the end of the year, our debt to Leucadia will be completely eliminated, and while we cannot guarantee that as these things are never final until they're done, it is increasingly likely as we reported before. We've done substantial and very strong interest that has now been translated into their robust processes and we have hopefully, you'll be seeing a string of announcements over next few months, in regard to the rest of the assets, and something that we are now getting increasingly confident in.

And with that, I think and hat's as one of the most important task for us this year was eliminating the debt to Leucadia. And this is something that we believe will be done before the one-year anniversary of the SMB crisis that got us into this situation and I think this is something that we're very proud of the team here for making that happen and while I said it's not done until it's done and we cannot guarantee that's the case. It is increasingly likely that is the case of this one.

Turning over to page 12. Just to go over where we're doing in the future in terms of our continuing operations as Robert said. And I want to kind of break it down the quarter on a monthly basis. Continuing operations was actually profitable to the tune of about $5 million in the month of April, by $6 million in the month of May, and we lost about $13 million in the month of June, just to give you sort of a continuing operations picture for the quarter.

As we've said before and as you heard competitors of ours mentioned there was exceptional market conditions and I see the market as well as some one-off things that occurred this quarter. We, as you all know from last year's conference call, we have been trying to transition our CFD business or primarily a principal business to introduce an agency component to it that will take over large portions at a volume, specifically from the larger customers and the more sophisticated lines. This is something that was due to be introduced earlier this year, the SMB event kind of pushed it all back. We have started over the last few weeks to phase that in. We believe that will be done in the next few months and I believe that will iron-out any future and exceptional volatility in our CFD offering, which has been very strong and fairly consistent in the last few years. Despite recent hiccup, we think not only is that hiccup fairly rare, we think also that on a structural basis moving the bigger clients to an agency model and moving some of the flow to an agency model will definitely iron-out the P&L issues in that business and ensure that that business is consistently profitable going forward on a much more sustainable basis than in the past.

As Robert also mentioned, we have moved -- we are starting to move small clients to our dealing desk model, which essentially means we take principal risk and we obviously have seen an increase in dollars per million currently. We are a third done in the moves that we're doing. In the next few months, we expect that to be completed. In the end, as we said before, this will -- this will still be a relatively small part of our FX flows and probably won't exceed in the perceivable future, more in the quarter of our FX volume, but it is something that we've already seen in places where we phased it in longer. We are gaining market share and we're doing well in accounts and kind of getting back the small clients that would kind of gave up on prior to SMB. And this is something that we are very confident in our future plan and now only it will raise our dollar per million and will also increase our market share and previously compete for our clients, we sort of -- when we were a (technical difficulty) FX decided that we would -- we're not non-profitable for us. The dealing desk initiative essentially makes that client base profitable, client base for us simply because of the higher yield. And it's something that we are going to be aggressively pursuing into next year as well.

All in all, I'd like to say that -- while accounts, equity took a hit during SMB and customer equity obviously, we're shedding some customer equity as Robert laid out in some of the disposals in Hong Kong, and Japan account equity from continuing operations is growing partially due to Citibank deal, partially and also organic. All that with an advertising budget that is 40% lower than pre-SMB period. This is something that we are very proud of that we have been sustaining and growing despite having a lower budget.

We believe that once the debt is paid or we get back into a more normal groove of running a company, we will be restoring set budget and we will grow even more aggressively.

So this is -- what we're seeing is actually very hopeful signs and a very as Robert laid out, we saw an increase in volume this quarter. We're definitely not shrinking or even growing to some degree of course. This is still not what we are satisfied with, not yet, where we hope to be. But it is something that, as we said before, our target for the end of the year and essentially for 2016 is to be solidly profitable and to be debt free. And this is something that we are, debt free Leucadia wise and this is something that we are very much on track to do.

To go over I think on a -- just to summarize what a little bit of what Robert went over, FXCM remains financially extremely strong. $273 million in operating cash, $863 million in customer equity, 181,000 accounts and we have a regulatory capital surplus of $117 million. And I think this is something that has given our customers increasing confidence that we are here to stay and are not going anywhere and it's something that has definitely helped us in weathering the storm and even growing through the storm as we've shown in this quarter.

And with that, we will turn over to questions.

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## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions). Lee Jagoda, CJS Securities.

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**Lee Jagoda** - *CJS Securities - Analyst*

So, Drew it appears the business has somewhat stabilized after all the noise we saw in Q1. And clearly there are asset sales that have been made, asset sales to come, but if you look at the business that you expect to be left post all these asset sales, what do you think the earnings power of the remaining entity will be over the next 12 to 24 months?

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**Drew Niv** - *FXCM Inc. - CEO*

So, if you look at, as a base, we start with sort of April and May earnings from continuing operations of $5 million to $6 million range. We believe that those represent a normalized CFD business. They represent, even though on a lower end, but still a normalized CFD business, a conservative approach to it. And a business still that where the move to dealing desk is only one-third done. So, with normalizing CFDs, move to dealing desk of small FX clients being completed over the next few months, we expect that earning power to be minimum to rise from that $5 million to $6 million range to $8 million to $9 million range a month. So about $100 million for the year or so, a little bit around that number.

Much of the growth path of that, that was kind of the base number that we have for next year and I think that we kind of can see from results this year. Obviously, we believe that we will experience some growth beyond that, partially from the introduction of upgraded platforms and so on and partially from the fact that once we are debt free, we will have increasing customer confidence in FXCM, which has definitely held us back as you can imagine. And I think that this is something that we are very much looking forward to and something that I think will surprise everybody. Once we don't have all the issues that you are seeing here, kind of the many of them are now repeated issues, I think the issue the Company has is from an operating perspective will be very strong, very solid, very lean. And we think it's in and around those ranges.

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**Lee Jagoda** - *CJS Securities - Analyst*

And just to be clear, after all of -- to the extent that you sell FastMatch and Lucid and V3 and all those others, that's after all of that?

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**Drew Niv** - *FXCM Inc. - CEO*

Yes, because the numbers I gave by April, May and June are only continuing operations. They do not include Lucid and V3 and as Robert mentioned, I mean V3 has been having exceptional performance in the last six months as the restructuring we've done since we bought it has finally taken hold and things are going really well there. Obviously market conditions for those businesses are heading in the right direction, with interest rates going up. So all of this, that business is doing well, but it's not included in those numbers because we are presuming that we are selling it in order to get to the debt-free goal that we want to do, which is still overrides that business.

I think that I would say that my numbers in my forecast, while an estimate that we can't really 100% predict, it does not include if interest rates rise, if macro conditions improve and really play in our favor. Obviously, those numbers look conservative.

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**Operator**

Thank you. That concludes the Q&A session. I will now turn the call back over to management for closing remarks.

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**Jaclyn Klein** - *FXCM Inc. - VP, Corporate Communications & IR*

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

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**Operator**

Thank you. Ladies and gentlemen, that does conclude today's conference. You may all disconnect, and everyone have a great day.

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