GAIN Capital

Fourth Quarter 2018 Earnings Release

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CORPORATE PARTICIPANTS

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Nigel Rose - *CFO*

PRESENTATION

Operator
Good afternoon, everyone, and welcome to the GAIN Capital Fourth Quarter 2018 Earnings Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. And please note today's event is being recorded.

At this time, I'd like to turn the conference call over to Ms. Nicole Briguet, Investor Relations representative of GAIN Capital. Please go ahead.

Nicole Briguet
Thank you, operator. Good afternoon and thank you to everyone for joining us for our fourth quarter and full year 2018 earnings call. Speaking today will be GAIN's CEO, Glenn Stevens, and CFO, Nigel Rose.

Today's commentary will be accompanied by our earnings slide deck, which can be accessed via website on our IR website now or at a later time. Following their remarks, we will open the call to questions.

During this call, we may make forward-looking statements to assist you in your understanding our expectations for future performance. These statements are subject to a number of risks that could cause actual events and results to differ materially. I refer you to the company's Investor Relations website to access the press release and the filings of the SEC for discussions of those risks.

In addition, statements during this call, including statements related to market conditions, changes in regulation, operating performance and financial performance, are based on management's views as of today, and it is anticipated that future developments may cause these views to change. Please consider the information presented in this light. The company may at some point elect to update the forward-looking statements made today, but specifically disclaims any obligation to do so.

I'd now like to turn the call over to Glenn.

Glenn Stevens
Thanks, Nicole, and thank you all for joining us as we close the books on a strong 2018. Today we'll start with a review of our operational and financial highlights for the fourth quarter and full year, and then we will shift gears and share our longer term strategic plan, which we believe will drive growth and increased earnings over the next three years.

Going to slide three, 2018 was a year in which we set the foundation of our success for years to come. We made significant operational progress, highlighted by innovative enhancements to our platform and a revamped marketing strategy. The results of our efforts are already being recognized in our performance and provide us the confidence that there is still significant runway for us to grow the platform and deliver value.

Let me take a moment to reflect on our progress over the last 12 months. We made significant strides in four key areas, starting with the product and customer service enhancements we delivered. We rolled out our new next-generation web trading platform globally and invested significantly in our mobile platform. We also launched a variety of improvements in the areas of onboarding and payments designed to improve the account opening experience for our clients while providing them with better and faster ways to fund their account.

We introduced new products and services for our high value clients. A key highlight in this area was the launch of our new Direct Market Access (DMA) offering in the fall. We also expanded our relationship management services and introduced a new rebate program to lower the cost of trading for our most active clients.

After a deep analysis of our marketing ROI, we made the decision to significantly increase our investment in marketing in the second half of the year to complement these product enhancements. These investments delivered solid new account growth, with new direct accounts increasing 18% as compared to the second half of 2017. It's worth noting that we achieved this growth in a year marked with significant political and economic uncertainty and overall relatively weak market conditions.

These efforts enabled us to deliver strong organic growth during 2018, with full year revenues increasing 29% as compared to 2017 and a full year EBITDA improvement of $58 million or nearly tripling, reflecting the operating leverage inherent in our business model.

In addition to these accomplishments, we had a very successful outcome on the corporate development front. In June, we announced the sale of our ECN business, GTX, to Deutsche Boerse Group for $100 million, with net proceeds of approximately $85 million.

With our solid operating and financial results and the proceeds from the sale of GTX, we were able to significantly increase shareholder returns. We returned approximately $80 million to our investors through repurchases, buybacks, and our longstanding quarterly dividend, with Q4 being the 29th consecutive quarter where we paid a dividend. In all, I feel our accomplishments in 2018 highlight our commitment to delivering long term value for not only our shareholders, but also our customers.

Moving to slide four, in reviewing our customer metrics for the fourth quarter and full year, it is clear that our efforts to drive organic growth are showing results. During Q4, our increased marketing investment helped deliver strong new account growth, which was up 16% year-over-year and 12% on a sequential basis.

Our trailing three month direct active accounts in the fourth quarter were down slightly. However, their volume per active increased 26% in Q4 2018 as compared to the prior year period, and 33% up quarter-over-quarter. This led to an overall increase in volumes year-over-year, which indicates higher client quality.

Now turning to slide five, which is an update on the new European regulations that went into effect on August 1st, our regulators in Europe and the UK introduced regulatory changes in the provision of CFDs, which lowered the leverage available to our retail clients from the UK and EU.

Due to a successful focus on professional clients, we were able to minimize the impact of the new measures and protect the majority of our revenue from those clients that are located there. While active accounts in that region were down 33% versus the prior year, that loss in active accounts came from our lower value clients. Importantly, trading volumes and client revenues were relatively unchanged from Q4 of 2017.

Our team did a great job navigating these new ESMA regulations, and I point to these results as another example of our ability as a company to successfully manage the regulatory change.

On slide six, our financial and operational performance throughout 2018 reflects our initial success in driving our retail business through customer experience enhancements and increased marketing spend. In all, I'm very proud of how our team executed this past year.

With 2018 now behind us, we are focused on the future, building on the strong platform we've established. I look forward to sharing more details on our go-forward plan a little later in this call. Before I review our longer term strategy and outlook, I will turn it over to Nigel for a deeper review of our fourth quarter and full year results. Nigel?

Nigel Rose
Thanks, Glenn. The following figures reflect results from our continuing operations.

Q4 2018 net revenue increased 27% year-over-year to $79.9 million as compared to $62.7 million in Q4 2017. For the full year, net revenue increased 29% year-over-year to $358 million compared to $278.2 million in the full year 2017.

Q4 2018 net loss was $0.7 million and adjusted net loss was $4.6 million. Q4 GAAP EPS was a loss of $0.02 as compared to a loss of $0.16 in Q4 2017, whilst adjusted EPS remained in line with Q4 2017 at a loss of $0.11. 2018 GAAP net income was $28 million, while 2018 adjusted net income was $29.1 million. 2018 GAAP EPS was $0.60 as compared to a loss of $0.29 in 2017.

Our tax rate for the year was 23% versus the 27% to 28% guidance we gave at the end of the second quarter due to some one-off items that arose in Q4. Going forward, we continue to expect our tax rate for 2019 and beyond will be between 27% and 28%.

Turning to EBITDA, adjusting out the one-time class action benefit, Q4 2018 revenues were $11.8 million above prior year, offset by the increase in marketing expense, which added to high variable overheads, resulting in EBITDA of $5.2 million against the prior year's $5.9 million.

In terms of the one-time revenue benefit, during the quarter the company received approximately $5.4 million as a participant in an industry class action lawsuit. The class action involved foreign exchange pricing that was made available to industry participants, including the company, with respect to its hedging activities. It is important to note the activity that gave rise to the class action had no impact on the pricing that was offered to the company's retail customers.

Full year 2018 adjusted EBITDA was $86.5 million as compared to $29.7 million in 2017, equivalent to a margin of 24% compared to the prior year's 11%. In other words, 76% of the year-on-year incremental revenue growth in 2018 converted to EBITDA. We have added slide 25 to the appendix of this earnings presentation, which provides some additional detail regarding EBITDA performance for each of the reported periods.

Turning to the retail segment, results for the quarter and full year reflect a period of muted volatility and the initial impact of our increased marketing spend that commenced in the second half. During Q4, retail revenue increased 23% to $64.9 million as compared to $52.8 million in Q4 2017. Total retail revenue for the full year increased 31% to $311 million.

Average daily volume for the fourth quarter increased 10% to $9.7 billion. ADV for the year increased 5% to $10.1 billion. As part of our increased investment, marketing spend was up 77% during fourth quarter as compared to Q4 2017, which impacted this quarter's profit margins.

Referral fees continue to decrease as a result of our focus on our direct business. Full year indirect volumes decreased 23% on 2017, in contrast to direct volumes, which increased 20%. In addition, the referral fee cost per million reduced 13% on prior year.

Segment profit improved 11% in the fourth quarter of 2018 as compared to Q4 2017 and more than doubled for the full year as compared to 2017, resulting in margins improving from 24% to 39%. Q4 2018 revenue per million of $97 was up from $90 per million in Q4 2017, whilst for the full year it was $115 compared to $93 in 2017. We continue to view our retail segment as the key driver of our business going forward.

Turning now to our futures business, revenues were $10.6 million for the quarter, up 12% from $9.5 million in Q4 2017. For the full year, futures year-over-year revenues improved 9% to $44 million. During the fourth quarter, we saw a strong uplift in average daily contracts with an increase of 28% year-over-year. For the full year, futures average daily contracts increased 16% as compared to 2017.

During 2018, futures profits almost doubled to $6.2 million, as did profit margins, which increased to 14% from 8% in 2017. We continue to see potential for further margin improvement for this segment should interest rates increase further.

I'd like to take a moment to review our overheads and capital expenditures. The left-hand chart shows the split between our fixed and variable overheads highlighting, as we've discussed in the past, the variable element that moves in relation to revenues and volume performance.

During full year 2018, fixed overheads increased by slightly less than 3% to $3.7 million, which was driven by increased investment in technology as part of supporting our organic growth strategy. The variable overheads increase was more notable, driven as it was by improved performance, which impacted bank charges, clearing fees, compensation, bad debt, etc., with variable overheads equating to 16% of revenues in 2018.

That said, overhead costs for 2018 came in slightly below our previous guidance at a $189.6 million. In terms of 2019 and beyond, Glenn will provide some additional commentary later in the presentation, but our expectations are that our overheads will likely remain at similar level for the next few years. We previously guided to a reduction in 2019.

With the increase in marketing investment now planned to continue into 2019 and beyond, we intend to invest the previously planned savings in areas such as technology to ensure we can support the anticipated additional growth.

Turning to capital expenditure, that decreased to $14.7 million in full year 2018 compared to $20.9 million the prior year, a reduction of $6.2 million or 30%. This is in line with our previous guidance of $14 million to $16 million per year, and we anticipate remaining at these levels going forward.

Shifting to our capital strategy, we continue to focus on four key priorities, required liquidity reserves, corporate development, quarterly dividends, and our share buyback program. GAIN continues to maintain a strong liquidity position, which was $316 million at the end of Q4 2018, an improvement of 46% over prior year. This represents a like-for-like 30% increase after adjusting for the impact of the share tender and the sale of GTX.

We have ample liquidity for corporate development opportunities and have now completed 11 transactions since our IPO in 2010. This includes the sale of our GTX business, which generated net proceeds of approximately $85 million, and we continue to be well positioned for future opportunities should they arise.

We remain committed to actively returning capital to shareholders, including through dividend payments and share buybacks. As such, our quarterly dividend of $0.06 will be paid on March 29th. As Glenn mentioned earlier, this represents the 29th consecutive quarter we have paid a dividend.

In addition to dividends, share buybacks continue to be a strong focus, particularly as we feel our shares remain undervalued. And in 2018, we returned approximately $80 million to our investors.

During the fourth quarter, net proceeds from the GTX sale helped fund our Dutch auction under which we repurchased almost 6.4 million shares of common stock at $7.84 per share. We also continued our quarterly share repurchase program during Q4, buying back almost 300,000 shares at an average share price of $6.85. This leaves us with approximately $24 million authorized and available for additional repurchases during 2019.

Before handing back to Glenn, let me just take a moment to recap our 2019 expectations that we've already touched upon. Whilst we expect modest volume growth, that will be tempered by a return to more normal RPM, in line with our long term expectations of $106.00 compared to the $115.00 we saw in 2018, noting also that we will see a material increase in our retail marketing spend from $35.4 million in 2018 to an estimated $52 million in 2019, consistent with our Q4 2018 run rate. This represents an increase of almost $17 million or 47%.

As just discussed, overheads will be similar to 2018 levels, while we anticipate CapEx will remain in line with our previous guidance of $14 million to $16 million per year. Finally, we continue to believe our 2019 tax rate will be in line with our original guidance of 27% to 28%.

And with that, I will turn it back over to Glenn to discuss our long term strategic priorities.

Glenn Stevens
Great. Thanks, Nigel. As promised, we would like to spend the remainder of this call discussing our strategic growth plan and introducing target metrics for 2021.

On slide 13, you can see the key to unlocking further value for our shareholders over the long term is by accelerating growth, which will grow top line revenue and increase earnings. As we kick off 2019, we are embarking on a three year strategic plan with four key pillars.

First is our level of marketing investment. Over the next three years, we intend to increase our marketing activities globally to drive an increase in new accounts and customer trading activity. This investment will be supported by continuous conversion optimization efforts. By improving the percentage of marketing leads which convert to new accounts, we will achieve an even greater ROI on our increased marketing spend.

Second, we are going to leverage our powerful brand assets in FOREX.com and GAIN Capital to compete on a global scale and grow market share by targeting two distinct customer segments, experienced active traders and retail traders.

Third, we remain focused on innovating the trading experience for all our customers, delivering best-in-class trading platforms, decision support tools, and delivering new ways and products for our customers to trade.

Lastly, our strong focus on premium clients, which will be achieved through our brand strategy and the development of products and services tailored for experienced traders. Collectively, these initiatives will help us with customer acquisition, retention, and engagement, and ultimately drive stronger financial results.

As we've said before, our marketing investment will be a key accelerator of organic growth over the next several years. Based on our results to date, we are confident in our ability to maintain our efficiency and ROI at the higher investment levels.

The chart on the left on slide 14 shows the breakeven on our marketing investment. Here we're looking at the breakeven for the first period of increased marketing spend, which was the second half of last year, 2018, and comparing that to the trailing 12 month period ended June 30th, 2018, or the most recent period prior to our increased marketing spend activities. After six months of increased marketing spend, we continue to observe a similar return on investment as we grow our overall new account numbers.

In addition, the cost per acquisition for our new accounts remains in line with expectations, which is benchmarked against three year account revenues. Also, with 54% of total 2018 revenues from loyal clients with a tenure of more than three years, new cohorts are expected to deliver a long tail of revenue even beyond our ROI benchmark.

In terms of setting expectations about marketing spend this year, we expect our 2019 spend to remain at Q4 2018 run rate, or about $52 million per year, as Nigel mentioned, and increasing further in 2020.

On slide 15, we're moving to show leveraging our powerful brand assets. As we've shared in the past, we have the unique opportunity to grow share in existing markets and increase our addressable markets in the future by leveraging our brands to target two distinct customer segments, experienced active traders and a broader retail investor group.

For experienced active traders who trade multiple asset classes and demand high quality tools, competitive pricing, and personalized service, the GAIN Capital brand is best positioned to meet these customers' needs and allows us to fully leverage our reputation as a trusted, well capitalized global provider.

The GAIN brand will be built on our existing customer proposition and global regulatory footprint with some exciting new products and service enhancements based on the extensive customer research we've done to help inform our strategy. The punch line here is that there will be a retail-facing GAIN Capital brand in the market later this year. This will replace our City Index brand that we currently operate in several markets. The plan is to launch the GAIN brand first in Australia later this year, followed by a global rollout that will continue into next year.

In parallel, we will continue to invest in our FOREX.com brand, which we've had in the market now for over 15 years and which enjoys very high brand awareness globally. With the FOREX.com brand, we will continue to build on our already successful track record of targeting self-directed retail investors looking to trade FX and most other popular global markets using our cost efficient customer acquisition model, along with a highly automated onboarding and funding experience.

The reach and brand awareness of FOREX.com affords us global expansion opportunities, including new language offerings to support our entrance into new regional markets. Because we are operating from a single technology stack now, the majority of our investments in trading platforms, tools, and other products and services will be leveraged across both brands, affording us economies of scale and greater operational efficiency.

That's a good segue to the next slide, which is all about our commitment to providing our customers with best-in-class products and service and overall trading experience. This is critical to our ability to drive client acquisition, engagement, and retention, as evidenced by the large contribution that comes from our long-tenured clients.

We will continue to enhance our market-leading suite of trading platforms and tools by continuing to develop our new HTML5 web trading platform, which was launched globally in the second half of 2018; also providing ongoing support for popular third party platforms with a beta launch of MT5 expected in the first half of this year, and delivering best-in-class decision support capabilities that are seamlessly integrated into our trading experience.

We also plan to increase the range of markets we offer. While we currently offer customer access to over 10,000 markets across FX, indices, equities, cryptos, and commodities, we do see an opportunity to expand our product range based on client demand and have built strong capabilities in that area that we can leverage over the next few years.

It's easy for us to add new markets now, including the latest IPOs and ETFs. We'll continuing to monitor the products our customers are looking to trade and add new ones as necessary. We also see opportunities to do more cross-selling of our existing futures offering as well.

In addition, our scalable technology infrastructure can support future expansion into other asset classes, including cash and exchange traded derivatives. In 2018, we launched our FX Direct Market Access offering, the first true prime of prime agency execution model for retail traders, and we're looking to add an enhanced options offering soon.

We've been talking for a while now about our focus on our most loyal and valuable clients, and that focus will continue over the coming years. We have been building our capabilities in this area to improve our ability to attract and retain this type of client. And we've invested quite a bit over the last year to build a global relationship management team, premium account packages, and pricing in other products and services tailored just for this group.

Looking ahead, the GAIN Capital retail brand is foundational to our future efforts in this area, as our goal with this brand is to be that top choice for sophisticated active traders globally. The GAIN brand proposition is being purpose-built with this type of client in mind in order to drive our ability to acquire this type of client and to increase their engagement with us, resulting in higher volume and higher revenue per client.

The next slide provides a view of how each of these strategic pillars contributes to our growth. Based on our planned increased marketing investment, we expect to generate a significant increase in new accounts. We have modeled the expected improvement from our conversion optimization efforts, which will further increase the number of new accounts, boosting volumes and revenue.

The launch of the GAIN Capital brand as a retail trading brand will help us successfully attract and retain experienced active traders and is expected to deliver higher volumes and revenue per client. In addition, our focus on premium clients is expected to increase revenue per active and build client tenure further.

These retail growth metrics, combined with a stable futures business, all build to a significantly higher 2021 revenue target.

Slide 19 provides more guidance on our operational and financial targets for 2021. On the operational side, we expect new direct accounts to increase in the range of 38% to 42% and retail volume to increase in the range of 30% to 35%.

Assuming this operational growth and our longer term expected RPM of $106, in 2021 we expect revenue in the range of $420 million to $460 million, our overhead costs expected to remain in the range of $190 million to $200 million, our EBITDA margin to be in the range of 30% to 35%, and EPS in the range of $2.15 to $2.40 per share.

In closing, during 2018 we delivered significant shareholder value and began laying the groundwork on several of our long term organic growth initiatives, including increasing our marketing spend and enhancing our customer experience. We are excited for the multiple levers we have to pull to accelerate our growth and grow the top line, and we look forward to reporting on our progress in the coming quarters.

With that, I will turn it to the operator for questions.

QUESTION AND ANSWER

Operator
Ladies and gentlemen, at this time we'll begin the question and answer session. To ask a question, you may press star and then one. If you are using a speakerphone, we do ask that you please pick up your handset before pressing the keys to ensure the best sound quality. To withdraw your question, you may press star and two. At this time, we will pause momentarily to assemble the roster.

And our first question today comes from Kyle Voigt from KBW. Please go ahead with your question.

Kyle Voigt
Hi. Good evening.

Glenn Stevens
Hey, Kyle.

Nigel Rose
Hey, Kyle.

Kyle Voigt
So, the first question is just on the regulatory environment, and appreciate the disclosure on the UK and EU client volume up 2% year-over-year in the fourth quarter. If we kind of back into, with the remainder of your client base, what the volume growth was for the remainder, I think it was about 15%, so I guess that's outside of the UK and EU. That disparity between the 2% volume growth and the 15% volume growth I just quoted, is that disparity the right way to think about how big the regulatory impact, roughly, was likely to volumes?

Glenn Stevens
I'm not sure I 100% follow. So, we have commented in the past on the potential impact from ESMA in terms of revenue. We haven't broken it out in terms of volume, but I'm not sure the 15, because the total--.

Kyle Voigt
--So, total volume is probably 10%, so I was just asking what the remainder was growing. So, I was just trying to isolate like what was the impact this year, and basically is it done on a go-forward basis.

Glenn Stevens
Well, the impact is done on a go-forward basis, yes, because the recharacterization of all those clients was done prior to the August 1st regulation change. So, it would be a step function down, if you will, and then this is your new baseline. And that baseline has been established since August 1st. So, to some degree if we're five, six months past that date, expectations are this is kind of the new normal in that market.

Kyle Voigt
Yeah.

Glenn Stevens
But in trying to answer your first question maybe--I think Nigel's got it right there.

Nigel Rose
Yeah. So, I think, Kyle, the 10% you're talking about is total Q4 ADV, Q4 '18 ADV over Q4 '17. Is that right?

Kyle Voigt
Correct.

Nigel Rose
Yeah. And then on slide five where we talk about UK and EU, we're saying for those--that subset, their volume was up 2%. So, within the 10% growth was the 2% growth from UK and Europe. Is that the right way to look at it for you?

Kyle Voigt
Yeah. So, I mean, you disclosed the European volume. So, if you back into what all the volumes were from outside of Europe, it looks like those volumes grew by about 15% to get you to that blended 10% aggregate.

Nigel Rose
Your weighted average of 10%, yeah. Yeah. I think that's the right way of looking at it, Kyle, yeah.

Kyle Voigt
So, is the variance--I'm saying between that 15% growth and 2% growth, that's likely how we should view what the impact was from the regulatory environment on your volumes in the fourth quarter. I'm just asking if that's a good way to think about it.

Nigel Rose
Yeah, I think that's a way of thinking about it, certainly, Kyle, as much as the fourth quarter was the first full quarter. And so, yes, I think that's a fair way of looking at it.

Kyle Voigt
Okay. Thank you. And then the long term RPM guidance of $106, I mean, last quarter you quoted a long term RPM guidance of $100 to $105. Just wondering why the increase in the long term expectations.

Glenn Stevens
Well, one of the things that we've been talking about kind of intermittently throughout the last few quarters are some of the positive strides we've made on some of our revenue efficiency from some of the more quantitative elements that we've infused into our processes.

So, it's a combination of optimizing our hedging to reduce some costs. It's also, as I said, using a lot more quant-driven efforts to see how we can optimize the way we get our hedging done through order types, through smart order routing. And initially that was--that model was rolled out at the end of Q1 of last year into Q2 in FX only.

And what we guided back then was that the model would continue to be rolled out across other products. We're still in the process of doing that. The model has remained in place for FX and it continues to show the benefit that we had hoped for. And now we're working through some of the other asset classes where it makes sense.

So, primarily two things. One is that overall, if our product mix stayed the same, then we make an assumption, with the same product mix, that's what our long term RPM would be. And it does move a little bit, 1% or 2% over time. We're also trying to reflect kind of our trailing 12 month, a trailing 24 month. And if you look at that channel that it's in, kind of between $100 and $120 over that longer period of time, we've seen it edge up a little bit with each kind of passing quarter or so. And we also do analysis to see that the efforts we've made on the quant side, on the hedging efficiency side, all those kind of cost and benefits, that they have a general net effect to the positive.

So, that's the primary drivers for us being heartened by moving it up. However, if we start to see a product shift towards more of our higher RPM products, so let's say we started to gain more traction in a market where, for example, in the U.S., you have FX only and in Singapore you have a multitude of products and our Singapore volume started to increase vis-à-vis anything else, then that multi asset RPM is higher, and so that would start to pull it up. Does that make sense?

Kyle Voigt
Yeah, it does. Thank you.

Glenn Stevens
All right.

Kyle Voigt
Last question for me is, just on the really strong new direct accounts, you give that slide, I think it's on slide four, and really in the last two quarters we've seen really strong metrics there. But I guess then the chart right below that, the three month active direct accounts, had declined over the last three quarters each quarter and really hasn't moved all that much since 1Q '17. So, I'm just trying to understand what's going on there, if there's been either higher attrition in the last quarters along with the higher new accounts, or whether these clients are opening the accounts and just not trading yet.

Glenn Stevens
Yeah, so I'll point you to a couple of items. On that same page on the upper right is a chart that shows direct volume per active, so you can see the tick up there in volume per active.

The other thing, to your point about trailing three month actives, with the ESMA change with the smaller clients who would count as active customers--so we don't do a weighted active customers. It's number of active customers. So, if you had a small account be active or a large account be active, then they would count the same. So, when we had to reclass a bunch of clients, as everybody did after ESMA, then you had a section of smaller clients that weren't joining, which means they weren't active, or didn't stay with us because they didn't qualify as professional clients so they didn't stay with us.

So, those would all be active clients that are no longer on their books. But because they tended to be smaller ones, then that's why you don't see the commensurate hit in volume or revenue per client and all those. And that's also our statement about kind of quality over quantity, and so we can see that the tendings towards higher quality clients is a good thing.

So, yes, you will see or you have seen that adjustment. And that's the other point we made, that kind of post ESMA you hit a steady state. And we've seen kind of from our own metrics that adjustment post ESMA, and then it stabilizes and then--has stabilized, and then you build in the other. So, if you look, for example, our January trailing three month actives increased. So, that's you building new clients, but that step function down that you pointed to is really reflecting the ESMA change.

Kyle Voigt
Okay. Thank you.

Glenn Stevens
Yep.

Operator
Our next question comes from Dan Fannon from Jefferies and Company. Please go ahead with your question.

Dan Fannon
Thanks. I guess just on the longer term outlook, can you talk about what the overriding kind of environment is you're assuming? Is it consistent with '18? And then, obviously it's predicated on account growth and they're from more sophisticated accounts. So, I guess where do you

see the biggest opportunity to take share, whether that's region or competitors? Can you talk a bit more about that?

Glenn Stevens
Okay. So, in terms of the environment first, part of our estimate or assumption with our RPM, the RPM isn't something you pick. It's something that's an output, right? But it's a reflection on what the environment is.

And clearly, in an environment that has higher vol around it in various products--because, again, every time we talk, you have to think about kind of CVIX. You think about regular VIX, which is where we talk about our GVIX. And when you talk about the longer term you say, well, sometimes you get multiple sets of products. Metals move. Energies move. Equity indices move and currencies move. And then you end up with a higher RPM like we saw with the $155. And then the other side of it is is that, if you end up with a scenario where a whole bunch of them don't, that's what you've seen in the past, we've posted $93s and that kind of period-over-period range.

Our assumption here is that the mix, to your point, would be normal. Yes, if '18 actually was higher than normal, and if you want to use trailing--multiple years of trailing 12 months, that for the full year $115 was higher than our normal $100 to $105. We've edged it up a little, as I said here, because we just had $115 in '18, and also because we look at some of the product mix and we look at some of the political environment going forward.

And so, of course you're making a bit of a vol assumption in terms of, well, what do we think it's going to look like? There's Brexit. There's Trump. There is interest rate change. There's other unrest globally. There's a lot of things going on which may or may not deliver higher than normal or lower than normal, but our assumptions are on a relatively normal market condition.

And in terms of how we can grab share, couple of things. Number one, we did actually put in our plan there the launch of our new brand, the GAIN brand, and so that's already geared up to, by design, to take share of the premium marketplace. So, it doesn't necessarily need legions of new customers, but it actually needs high quality customers. And that brand is being worked on, positioned, and ready to roll out to do just that.

Another accompaniment of that is our unique DMA access account, the Direct Market Access account. That's a first of its kind and very unique to our customers, and so there's another way to grab market share for that higher profile, active professional type customer. We don't have a peer in that space.

And again, that won't be applicable to masses of clients, but it will be applicable--already is. We already have clients signing up on that, and that drives that kind of quality over quantity idea again. So, positioning the brand with the commensurate products and services that go along with it is one way to enhance our market share globally. And that brand, by the way, is situated to be able to work in all of our markets, Asia-Pac and UK, Europe, and U.S.

And then the other part that we mentioned is actually not necessarily to grab more share, because part of that is our materially higher market spend that we alluded to. You can see that step function up in the last two quarters of the year. And our expectation is to maintain that higher level throughout this year and beyond, and the early results are very promising. And if you look at that, how it's going, we may end up with some additional switchers and new clients coming into our market.

And then the other part of it is, besides the spend, is the conversion optimization. So, even at higher levels of lead generation, if you can convert a higher percentage of those through easier funding, through a more intuitive onboarding experience, even if you don't get the commensurate pop from the spend, all of it that you might want, you can still improve things by converting more of the funnel.

Dan Fannon
Okay. Then just to clarify, so there's no M&A assumed in this guidance.

Glenn Stevens
That's right.

Dan Fannon
And then with that, I guess, Nigel, what's the share count, just to get the kind of the EPS? Like, what are you assuming from a kind of capital return perspective during that time period?

Nigel Rose
Yeah. So, the model we had assumed sort of run rates we were seeing in 2018 of around sort of $4 million a quarter.

Dan Fannon
Got it. Okay. Thank you.

Glenn Stevens
You got it.

Operator
Our next question comes from Rich Repetto from Sandler O'Neill.

Rich Repetto
Yeah. Good evening, Glenn. Good evening, Nigel.

Glenn Stevens
Hi, Rich.

Nigel Rose
Hi there.

Rich Repetto
Yeah. So, I guess the question is on the marketing and what you've laid out. I guess I'm struggling a bit to--I can see the direct accounts in the bar chart on page--I think it's five. But can you help us sort of see the higher return, I guess, from these accounts? Like, on page 14, when you talk about the spend, I'm confused on what are we looking at. What's on the X-axis? What's on the Y-axis? And I guess in the months I get, but what are you measuring here, the revenue actually coming from that client?

Nigel Rose
Yeah. So, the lines there are looking at measuring the difference between the marketing spend to acquire the customers and then the revenue those customers generate, so it's the net of those two numbers.

So, as you probably appreciate, when you first start you spend the money, you get some customers in generating revenue, and then you bring in more and more customers. And at some point there is a point in time, Rich, which is represented by the dotted horizontal line, where the revenue from the customers you've acquired has paid back the marketing spend. And then beyond that, you're sort of into positive territory and you're getting a positive return on that marketing investment.

Glenn Stevens
So, I think what's important, Rich, on the takeaway here is very similar to maybe a discount equity broker model, where you have a cost of acquisition and then you have the lifetime value of a client. In the past, we haven't illustrated our example of we have acquisition costs and then we have a lifetime value of a client based on their transaction volume over time. And what we've used is a three year time value, because the three year value is very representative of our clients' relationship with us.

However, we've also alluded to the fact that we have a big chunk of customers, over 50%, that are longer tenured than that. And so, arguably that's a conservative measure because it doesn't stop at three years. We have quite a few clients participating and contributing after three years.

But for the purposes of this study and to illustrate our confidence about the higher marketing spend, the blue line or the longer line is supposed to show trailing 12 months up to the point when we decided to make a material increase in spend. So, that's the idea of the second half of '17 and the first half of '18, so that 12 months. And then in the start Q3, we significantly ramped marketing after a lot of studies and a lot of work and a lot of analysis. And then we tried to show the green line there to say, well, here's the first six months of that higher level of spend.

And what we would want to see is a similar path, because it means that our capacity to spend that money effectively is experiencing the way we want it to. If that line was below, then you'd say, gee, for whatever reason, the efficiency or the marginal benefit of the extra marketing spend isn't working well. And so, the idea wasn't for it to be better than that line--hey, that'd be great--but the reality is, if it's similar type of marketing approach, you'd want it to have the same to illustrate that capacity in the market.

So, what we wanted to show there was, well, here's the previous year, full year, and then here's the first six months of our experience. So, of course, we didn't want to show this graph after the first month or three, and we didn't want to wait for two years either, so that's what we've shown here.

And then at the M's there is the first month, 12 months later, and two years later. And then the breakeven point is just to show, hey, here's where that payback from the acquisition cost starts to kick in, and of course it stays about that over time. And any movement, if the customer stays longer beyond the three years, that's additional value from that initial marketing dollar. And if we started to see inefficiencies in the market then, as we provide updates, that green line would start to go under the black line. Does that make some sense?

Rich Repetto
I get the general concept. I think where I'm getting thrown off is that--like, if this is per unit, I guess maybe it sort of makes sense. But the thing that's different here is that, compared to, say, just the second half to the first half of the year, you almost doubled marketing spend. And I don't see how that--I guess I'm not seeing how--maybe you're traveling up the curve in the same

time frame, but I'm just not seeing how that equated--equaled back to either doubling new direct accounts or doubling volume or anything like that.

Glenn Stevens
Well, a couple of things. Keep in mind that it is per unit. And so, that's to compare the spend, and so it's a spend on per month. So, this is six months of spend, and you look at how the revenue curve is generated from each month of collection, of activity. So, we started to spend in July. You have customers that came in arguably connected with that spend in July, and you look at their experience post July for the six months. And then you do the same thing for the next month. And you pile all those curves on, and collectively they build that unit curve of all those cohorts.

And then the other piece is the concept that this is not total clients. These are all new clients coming from that marketing spend, so it's on the margin with that. So, the other thing is that we're trying to say that, again, if you are doubling the spend, our unit breakeven, meaning the cost per acquisition per client and the time it takes to breakeven and then go positive, has actually remained the same.

Nigel Rose
Yeah. And just to add to that maybe sort of just extend the point, if the blue line, for example, where we spent $25 million in marketing, and that was represented by the blue line we paid back in nine months, and the green line is representing a $50 million annualized spend and it pays back in nine months, within nine months time, in the same period of time, you've effectively got arguably twice the customers, twice the revenue all now paying back after nine months versus spending $25 million nine months later, you've only got--they're paying back, but you're only getting half of the revenue you were getting when you were spending $50 million and then payback in nine months.

Glenn Stevens
And that's why we put the model in, to show--that's the whole reason for adding the model with the additional marketing spend, to show where our expectations are as this will play out for our financials.

Rich Repetto
Okay. So, then the next question is you'd said that marketing would go even further up in 2020 and 2021. So, could you give us little feel? Are we talking 5% up? Given the increases that you're seeing, can you give us sort of a feel?

Glenn Stevens
Yes, that'll be performance-based, Rich. I mean, the whole purpose of observing this and having the data and having the ability to track it almost in real-time is the benefit of--what we did say is we're encouraged by the initial results from the first six months of an increase in marketing spend. I don't, standing here today, expect we'd have another material step up like this.

However, the whole idea is to say that, if the marginal benefits from the increased spending continues to pay dividends, then that's funding that. So, for example, if you go from kind of a $52 million to $55 million run rate for this year and we see that that's paying the dividends over the time period Nigel mentioned is paying off, then yeah, you might go from $55 million to $65 million. But you wouldn't do it without the supporting evidence and you wouldn't do without it being funded by the success.

And the benefit here is that, as you start to reach certain inefficiencies in certain regions--because this is a global approach but we bring it all the way down to a regional basis--there might be some mix shift where in some cases some markets would absolutely warrant that increase that you've mentioned, and in other markets it might warrant a decrease. So, those are the levers that we've pulled to optimize it. It's not just a blanket, hey, spend $20 million more. It is which market is showing the best use of that additional spend.

Rich Repetto
Okay. And then the last question would be I guess on the RPM. I know you've put in improvements to probably take volatility out and stabilize it some more. We're still seeing a pull back and what appears to be pretty volatile markets in 4Q. So I guess the question is how did--those enhancements that you did to the market-making program, how would you judge or evaluate them, given that the RPM did go down versus a volatile environment overall?

Glenn Stevens
Yeah, I think a couple things. So, the program and the effort and the quant driving the RPM was never expected or designed to have impact over short periods like a quarter. It was designed to have longer term impacts so that we could see a positive trend over time, with all things being equal, would we end up with a better RPM. You're still going to be subject to tailwinds and headwinds of pockets of vol or not.

I think I would differ a little bit. If you look at the vol in Q4, that was pretty concentrated to quite a small amount of time. For the bulk of Q4, I don't believe particularly even in equities or in currencies we had that kind of movement. It was pretty concentrated to the backend of Q4, as a matter of fact even maybe a couple of weeks. So, in terms of saying that, hey, what happened even though you had all that volatility in Q4, I'm not sure I would say that that necessarily described the whole quarter.

The second thing is, as you know, we are made up of both the currency volatility measure, the CVIX, and the general VIX, and those can run in tandem or not. And so, with that together, we look at our product mix too. And sometimes our customers will--whether it's a trend or whether it's volatility, will be drawn to one set of products or another. Because they're all on our platform and they're all available, we'll see our customers gravitate towards one or another, and that'll help drive it.

I think the main takeaway here is that we've seen some--we've actually built in some improvements for the 12 month trailing. That's the $106 kind of going from a $102--$100 to $105, $102.50 up to $106. So, it's a nice move up, but it's a gradual move up and it'll continue to make some benefits, as I mentioned earlier.

Rich Repetto
Yeah. Okay. Can I squeeze one last one? Since we've reported late in the quarter, we're two months through the quarter, can you just give us a quick view of how the profitability on the RPM is going?

Glenn Stevens
So, Rich, it wouldn't be you calling if you didn't ask. That's good.

Rich Repetto
Exactly.

Glenn Stevens
Everybody's got to.

Rich Repetto
Yeah.

Glenn Stevens
But, I mean, ultimately, we reported our January metrics. I think that many people in this field started off the year with some lower levels. If you look at the level of the CVIX and you look at level of the VIX, the January numbers were lower than December.

As we get into the second part of this quarter, if you will, I think by some measures February has shown a few pockets. By the same token, I think, again, just kind of natural observation with all the different markets, it seems to be a little bit of calm before the storm too.

We've got a bunch of things on the horizon with Brexit and with plenty of the comings and goings in multiple markets, so yeah. So, I guess the answer would be we've seen some progress. And by the same token, you started the quarter with a softer January and so we see how the quarter plays out. I mean, yeah, we're almost two months in, if you will, but by the same token, as you rightfully noted, in Q4 of last year, with some pockets of volatility within a quarter, that those can work out okay too.

Rich Repetto
Great. Okay. Thanks, Glenn and Nigel.

Glenn Stevens
Okay. You got it.

Nigel Rose
Thanks.

Operator
And our next question comes from Ken Worthington from J.P. Morgan.

Ken Worthington
Hi. Good afternoon and thank you for taking my questions, maybe the first just to follow up on something that Rich said. The impact of the quant and hedging strategy, you've seen very large swings in RPM historically. My impression is the hedging would have a real impact in reducing that sort of revenue volatility. And sort of the way you just described it was it wouldn't necessarily show up in any one quarter, but over multiple quarters you would see a decline, which makes me feel like there's not a big impact, so maybe if you could re-describe the magnitude that you think your hedging and quant strategy will lower the volatility of RPM over time.

Glenn Stevens
Sure, Ken. So, the first way to answer it is that, when we measure its full effectiveness, it will be when it has fully been integrated into all of our products. So, for example, when we rolled it out in Q2 and we applied it to the major currency pairs where there is a lot of volume, we've seen improvements, significant improvements in measures like Sharpe ratio, daily P&L variation, things like that.

So, by some smaller unit measurements, it's doing what it's supposed to do it. And again, not day to day, not even month to month, sometimes not even quarter-to-quarter, but over time it's shown improvements. For example, when you go back to--I guess it was maybe Q3 of '18, there was a big disconnect in the Turkish lira which led to some other products that also kind of bumped out. Those products weren't even under, and we had mentioned back then, those products weren't under the program. And for example, our equity indices and our single stock equities are also not under the program yet.

There is time to develop the models and time to deploy the models and test the models to make sure it works. So, every quarter that goes by, we fold in another product set or two with the design of saying that, as we get into this year, we try to see how that goes. If you look at the FX standard deviation, for example, over this same period, that's lower by 16%. So, there's an example of lowering the standard dev on the part of the program that's subject to this.

So, if you take the old one compared to the new one over the same period, that's one measure. So, as I said, the Sharpe was improved, the standard deviation has improved, but the other products aren't online yet. And that's also part of the reason why we're not putting out kind of a vol on this or a variation on this, but we get the side benefit of a net improvement as well.

Ken Worthington
So, maybe to help out a little more, you did an RPM of like $97 this quarter. Do you have any guess of what that might look like? And that $97 is both your new kind of long term average RPM and maybe the former RPM. What might this have looked like if these strategies were fully deployed?

Glenn Stevens
Let's put it this way. If the strategies were fully deployed across all the asset classes, I think our model assumption is for $106 longer term. So, arguably--and that is with the model fully deployed across all the asset classes. So Q4, arguably, by design would look closer to that longer term average.

However, over a short period, if there was a product set within there whose vol either was up or down, the $97 could have been $117 because, look--I'm stretching, but let's say $110, or it could have been $90 because a particular product set kind of was out of that. I mean, ultimately in terms of all the vol, it's kind of--because there are different product sets that are driving this, sometimes you can have one stick out in a quarter up or down. And if it's a chunky part of our volume, it'll drive short term RPM regardless of the model, because the model's not going to have neutralized a lower vol or higher vol in, let's say, equities or in currencies or something like that.

Ken Worthington
Okay. Thank you. Thinking about the three year outlook, can you tell us the assumptions that you're making for account attrition? Maybe where has attrition really been? And do you expect it to change between where it's been more recently and where you would expect it to be in 2021? Is that one of the drivers here as well maybe beneath the surface to your other assumptions?

Glenn Stevens
I think that if you looked at slide 16 and--15 and 16--they don't address it so I'm not calling you out on that. What I'm saying is that improving our trading experience and kind of solidifying the two brand assets we talked about, FOREX.com and GAIN Capital, the purpose of that is to

extend the tenure of the client, to improve retention. And those two, arguably, are supposed to improve the attrition rate.

And so, to answer your question specifically, our model builds in a modest improvement in attrition against historical trends, because of these changes we're making, if you will, improvements, enhancements. Other than clients exiting the market for reasons we haven't discovered yet, we want to reduce switchers, reduce other reasons why they--we try to make them more sticky because higher value clients are definitely more sticky, and we've seen that. And so, making distinct improvements to our higher value premium clients by design will give us a better tenure and a higher stickiness or retention rate for our clients too.

Ken Worthington
Okay. And then lastly, in your three year outlook really guiding to three things, big new account growth, flat RPM, and flat expenses, there are assumptions behind these driving these outcomes. If your assumptions prove to be overly aggressive or overly conservative, which of the drivers do you think would be off and why? And I guess this goes along with where do you feel most confident and least confident in these outcomes that you're suggesting?

Glenn Stevens
Well, on our expense discipline, we're pretty confident that we can manage that effectively, because the kind of multiple expansion or the leveragability inherent in our business model is such that those expenses are pretty clearly not going to be dragged up by higher business levels and volumes, customers, what have you. We've modeled out quite a bit of our capacity from a technology perspective to absorb a big spike in activity and volume to new customers by automating a lot of the processes.

For example, on the FOREX.com brand, we're able to scale that effectively because it doesn't--it's not going to take a whole ton more reps and things to handle all these more customers or have them onboard. So, in terms of expenses, I think we're really confident about saying, hey, we can manage that effectively. We're not expecting any surprises there. And as a matter of fact, we're expecting positive surprises because, if you have opportunities to be either quicker on transitions or figure out better ways to even reduce our cost base, we're constantly searching for that. So, that's number one.

In terms of the marketing spend, again, that is a voluntary spend. We haven't booked three year contracts at levels and said we're set and that's it. So, of course, when you say confidence, we're confident that that's going to pay off. Otherwise, we wouldn't be spending it.

But in terms of having the recompense to be able to change that level commensurate with profitability and revenues, as I said, we can invest at even higher levels as it makes sense or invest at lower levels as it makes sense. And that, again, can happen on a regional basis, on a brand basis. There are all these levers. It's not a one-shot global that's it. These actually are collective additives of different models within that.

The last one I guess is our $106.00. And that's a relatively, we would argue, representative sample of one, two, three, five, seven years worth of RPM even to get a feel for it. We have some built-in underpinnings of improvement that we alluded to before about the more quant-driven strategy that we're using for hedging and modeling and data analysis.

But, of course, you can look back at 10 years' worth of any markets and try to get a feel for what the vol looked like if we wanted to break it into one year chunks and say, well, gee, did we have a 2017 in there? Did we have a 2006 in there? I'm picking out some years of particularly low vol. And so, would that put a little kink in the timeline? Sure, but just as easily you can end up with a year that's an outsized vol year, 2016, 2008, what have you. And so over the three, you can end up with all three; a medium one as expected, a higher than expected and a lower than expected, but that's probably the one we can't control. But the good news is that we have some levers to pull to navigate around it.

Ken Worthington
Okay, great. Thank you very much.

CONCLUSION

Operator
And ladies and gentlemen, with that we'll conclude today's conference call. We do thank you for attending today's presentation. You may now disconnect your lines.