# GAIN Capital Holdings Inc.

## Third Quarter 2019 Earnings Conference Call

## Thursday, October 24, 2019, 4:30 PM Eastern

**CORPORATE PARTICIPANTS**

**Glenn Stevens** - *Chief Executive Officer*

**Nigel Rose** - *Chief Financial Officer*

**Nicole Briguet** - *Investor Relations*

## PRESENTATION

**Operator**
Good day, everyone, and welcome to the GAIN Capital's Third Quarter 2019 Results Conference Call and Webcast. Today's call is being recorded.

At this time, I would like to turn the conference over to GAIN Investor Relations representative, Nicole Briguet. Please go ahead.

**Nicole Briguet**
Thank you, operator. Good afternoon and thank you to everyone for joining us for our third quarter 2019 earnings call.

Speaking today will be GAIN Capital's CEO, Glenn Stevens; and CFO, Nigel Rose. Today's commentary will be accompanied by our earnings slide deck, which can be accessed via webcast 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 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 with the SEC for discussions of those risks. In addition, statements during this call, including statements related to market conditions, changes in regulations, operating performance and financial performance, are based on management's view 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 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 thanks to everyone for joining us today.

During the third quarter, we saw continued positive signs of client engagement. In our retail segment, we continued to deliver new account growth which nearly doubled over last year and grew 32% sequentially positioning us well for the return of normal market conditions. Pockets of volatility in U.S. equities supported growth in our futures business, which saw a 24% increase in average daily contracts in the quarter compared to last year.

Turning to our financial results, Q3 net revenue came in at $66.7 million with an adjusted EBITDA of $6 million.

Turning to slide four, in Q3, our marketing investments delivered a fifth consecutive quarter of new account growth. In addition, trailing three-month active accounts improved 5% over last quarter. We are encouraged by these results and believe in our continued success driving organic growth.

On the next slide, digging into our active customer base, our continued success in acquiring new customers has been translating into consistent growth in our active customer numbers. As you can see on the chart, our trailing three-month actives increased for a third consecutive quarter putting them 10% above the level last in Q4 of '18. Notably, actives were above Q2 levels of '18, which was the last full quarter prior to the implementation of ESMA regulations.

We remain well-placed for when volatility returns. A good short-term example being the recent oil price move tied to the missile strike in Saudi Arabia in September where our platform experienced a five-fold spike in crude oil volumes. Examples like this prove that we have sizable stored client potential, which will materialize when volatility returns.

In addition to the new and active account growth we're seeing, the four other key metrics we use to evaluate our marketing performance remain on track and they are – our cost per new account. After five quarters of increased spending levels, we continue to track below our targets. Breakeven points – the timeline to recover the marketing investment from each cohort remains on track with Q3 results in line with our expectations. Our internal rate of return – our more recent IRRs on customer acquisition costs continue to exceed our expectations and validate our marketing spend as a strong use of our capital. And finally, our long tail of revenue – while a healthy percentage of our revenue continues to come from long tenured clients, as our new accounts become active, the mix of client transaction revenues has begun shifting to our newer customer base. We continue to expect that the newly acquired customers will deliver revenue well beyond our ROI benchmark, which is based on a three-year lifetime value.

In addition, we continue to analyze ways in which we can optimize our spend in local markets to increase yield and/or reduce our spend with limited or no negative impact. Consequently, given the prevailing unusually low volatility environment, we are targeting 2019 annual marketing spend to come in closer to $41 million or up about 16% over last year.

In the past we have spoken about the AI-driven hedging model that we have developed and deployed. Thanks to our focus on leveraging data to drive more effective pricing and improved risk management, our new hedging model continues to outperform our past approach to hedging activities. Our stated objective for this effort was to reduce variability of revenue capture.

Two commonly used measures for variability and risk management are standard deviation and the Sharpe ratio. Our standard deviation of daily revenue is now more than 25% lower under the new model. While our Sharpe ratio is almost 50% higher. So, in both cases we're seeing marked improvements. Fortunately, improved variation metrics are not expected to come at the expense of our long-term revenue capture, which will continue to trend in line with our previous guidance of 106 RPM. We are pleased with our progress to-date and we'll continue to apply this model to a broader range of products in our portfolio. We originally applied our new model to FX only and we expect metals and indices will go live this quarter.

Looking forward, our long-term strategic priorities to accelerate growth remain intact. The four pillars of our growth are rooted in our data driven approach to customization. A few notable examples, with our marketing investment, we're leveraging detailed cohort payback and internal rate of return analyses to enhance and customize our spend at the regional and product offering levels.

On innovating the trading experience, we're using data to get a better understanding of how our customers' trade and what their preferences are to enhance our platforms to better suit their requirements on a customized basis. By personalizing our trading experiences based on regional, product and customer segment preferences, we can drive higher engagement and activity thereby extending lifetimes and lifetime value.

I mentioned a great example of this earlier with the recent price movement in oil. In August, we introduced a new spot crude product to complement our existing futures offering and provide our customers with a product they more easily recognize.  This afforded us the opportunity to take greater advantage of the spike in activity, with that new product accounting for almost half of the volume during that short-elevated period.  Data is also helping us become more proactive in identifying potential premium clients much earlier in their journey with us and helping us understand how to better engage with them.

As I reflect on the past nine months and look forward, I'm encouraged about our position to deliver long-term value.  We acknowledged that we have witnessed a period of unusually low volatility that has had an adverse impact on our ability to deliver short-term financial results.

With that said, we've not watched from the sidelines, but rather have been proactive and evolving our business model and our marketing efforts that has grown our customer base, which is critical to the long-term success of this business.  Ultimately, our broadening base of customers will drive event-driven volume increases, enhancing the benefit from our improving operating leverage as we reduce our expense base even further.

We have repeatedly delivered expenses at or below the lower range of our guidance and expect to continue to do so.  Our ability to better capture revenue opportunities coupled with expense management will ultimately allow us to maximize profitability.

With that, I'll turn it over to Nigel for a deeper review of our third quarter results.  Nigel?

**Nigel Rose**
Thanks, Glenn.  During the third quarter, net revenue decreased 30% year-over-year to $66.7 million as compared to $95.5 million last year.  GAAP net loss was $2.1 million resulting in GAAP loss per share of $0.06 as compared to net income of $10 million and GAAP earnings per share of $0.22 in the prior year.  Adjusted loss was $2.8 million and adjusted loss per share was $0.07 as compared to adjusted net income of $13.8 million and an adjusted EPS of $0.31 in Q3 2018.  Adjusted EBITDA was $6 million compared to $30.5 million in the year.

In our retail segment, market conditions or our quarterly ADV decreased to 10% year-over-year to $7 billion.  RPM of $114 for the quarter was slightly above our long-term expectations, but below the standout RPM of $164 seen in Q3 2018.  The combined impact of ADV and RPM saw total retail revenue of $57 million, a year-over-year decrease of 34% with the RPM differential accounting for almost 90% of that reduction.

Marketing for our retail segment was up 36% for the first nine months of 2019 as compared to the prior year period as we remain committed to our organic growth strategy.  Retail overheads for Q3 and the year-to-date were both down 6% over the prior year, reflecting our continued focus on our operational efficiency strategy.

Turning to the futures business, revenues were up 9% at $10.6 million for the quarter as compared to $9.7 million last year.  While futures average daily contracts increased 24% to 31,895 during Q3, revenue per contract decreased to $4.59 due to shift in product mix but remains in line with the year-to-date and trailing 12-month averages.

Overheads for the future segment year-to-date were 4% lower over the prior year period. The profit margin for the futures business improved to 16% in Q3 2019 and up slightly to 15% on a year-to-date basis compared to prior year.

I'd like to take a moment to provide an update on our overhead guidance. On our Q3 earnings call, as a result of continued optimization of our cost structure outside of our growth initiatives, we guided to overheads this year coming in near $180 million compared to the original guidance provided during Q4 '18 earnings of $190 [million] to $200 million. With one quarter left in the financial year, our overhead stand at $132 million equating to an annualized, at $176 million. The further reduction below the previous $180 million plus guidance has been driven in part by a reduction in the variable component arising from financial performance this quarter.

At this stage, our 2020 guidance remains within the range previously provided, namely $170 [million] to $180 million. We remain committed to pursuing opportunities to further streamline our overhead expenses, which we believe will ultimately enable us to create stronger operating leverage as well as allow us to be profitable should the unusually weak market conditions continue.

As a reminder, in Q1 we decided to amend the presentation of our liquidity to directly align with the cash and cash equivalents figure shown on the balance sheet. We made this change as we believe it’s preferable to reference the cash reported on our balance sheet and how that has moved period over period as set out in the appendix to this presentation.

We continue to balance the uses and needs for our cash in the order that diagram on this slide shows, the primary priority being to ensure GAIN has the liquidity it requires to operate efficiently and effectively.

At the end of the quarter, GAIN had total cash and cash equivalents of $200.7 million. Broker receivables continued to remain at heightened levels, being at $107.7 million at the end of Q3 2019, almost double the prior year's $57.5 million. This reflects an increase in the size of our hedge positions caused by the growth in open client positions, which is a good lead indicator for future revenue.

Secondly, we remain committed to actively returning capital to shareholders through dividend payments. As such, our quarterly dividend of $0.06 will be paid on the 17th of December. This represents the 32nd consecutive quarter GAIN has paid a dividend, a period stretching back to 2011.

In terms of the next priority buybacks, GAIN did not repurchase shares during the quarter as we believe it remains more prudent for now to retain capital during this prolonged period of low market volatility. In addition, we are conscious of our $60 million convertible loan falling due next April that we intend to repay, which will also reduce the interest expense impact that has on our profits. However, we still remain committed to actively returning capital to shareholders with a buyback being a key component of that. A good example being, we recently bought back a portion of the 2020 converts. In terms of share buybacks, we have approximately $41 million authorized and remaining for additional repurchases as of September 30.

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

**QUESTION AND ANSWER**

**Operator**
Yes. Thank you. We'll now begin the question and answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. If your question has been addressed and you would like to withdraw it, please press "*" then "2." At this time, we will pause momentarily to assemble the roster.

And the first question comes from Dan Fannon with Jefferies and Company.

**Dan Fannon**
Thanks. My first question is on capital, the no buybacks in the quarter. Just curious as to why, just looking at the share price action? And then ultimately, just thinking about M&A and the construct of a low-vol environment, you've talked about how that puts pressure on some of the more...the smaller competitors with less scale. So, can you talk about the environment today for potential M&A as well?

**Glenn Stevens**
Sure, Dan. They actually tie in a little bit together in that number one because we don't feel like we have an option using our equity at these prices for M&A, that leaves cash or seller financing, other creative measures, but particularly cash as our best option for opportunities that arise in this low-vol environment. So that dovetails also with our decision to temporarily scale back some of the buying back our own stock, which we've been, number one, pretty consistent with participating in, and it's not off of our slate of options going forward by any measure.

But the two of the items, number one, some of the M&A that you mentioned, trying to be prudent and timely for that, and the second part of it is, we are planning to pay off the first tranche of our debt in April of '20, which is about $50 million or actually a little higher than that, about $60 million, to pay off that full note. We brought a small portion back of it, but I'm essentially making sure that's earmarked and geared to be paid off. So, we'll be mindful of that as well in this environment where it's more difficult to generate a lot of excess cash. So, on both sides of those, we made the decision over this quarter to do a little bit of “wait and see.” So, I guess the combination of the two, number one being prudent and having that available without changing any of our operations or strategic levers to pull. And number two, from an M&A perspective, you're right that the environment is interesting for us, but I don't believe we have, at present value, stock as one of our levers to use.

**Dan Fannon**
Got it. And then, just with regards to expenses, understand, the marketing and the outlook for that in the fourth quarter. Just surprised in the third quarter that the G&A number went up sequentially, as much as it did. And just if there's anything behind that you are thinking about G&A going forward, in the context of the overall overhead costs in the framework you gave us, Nigel.

**Nigel Rose**
Yes. Good question, Dan. Yes, you're right. It did step up in Q3 in part. There was some one-off costs in there, which by their nature won't repeat. And in part there was a bit of a step up within the variable component in relation to bank fees and the fees we pay payment providers for processing customer deposits and withdrawals, which we saw as a positive and as much as

we're seeing a little bit more engagement from those guys now in terms of their funding and trading to some degree.

**Dan Fannon**
Okay. All right. Thank you.

**Glenn Stevens**
Thanks, Dan.

**Operator**
Thank you. And the next question comes from Rich Repetto with Sandler O'Neill.

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

**Glenn Stevens**
Hi Rich.

**Nigel Rose**
Hi Rich.

**Rich Repetto**
My question is, first on slide seven, when you show the hedging, the AI-driven hedging model. I guess you're looking at the standard deviation of daily revenue, but when I just take a look at your RPM over this same period, it certainly looks like that's very volatile when you had $50 and $164. So, I'm not up on my statistics here, but can you explain the difference between, how we get to the numbers for the quarterly RPM when everything in your chart shows, we're reducing volatility?

**Glenn Stevens**
Totally fair question. Part of it is perspective and so what I mean by that is, one, there are slightly two different approaches. On the one hand, the standard deviation that is reported daily is ultimately designed to drive a narrower range over quarters and over a longer period, so, not so much in a vacuum, but from a daily measure, we have seen a relatively consistent march into a lower standard deviation on P&L day-to-day. Now we don't report a daily P&L, but of course we track our own daily P&L and ultimately by driving a narrow range of outputs there that will stack up into a narrow range of variability from, in this case, quarter-to-quarter. That's going to be over time. The reality is that the older model, go back Q1 of '18 was…actually have a wider range for daily standard deviation of P&L, and it actually did drive a higher, sorry, lower Sharpe ratio. So, you want lower standard deviation, higher Sharp.

Now to your point, when you look back for the last two quarters, for example, and look at the $164 and the $50 and you add the two of them together, it goes right smack again to our average of $105. So, yes, on two quarters with an up and a down, you'd say, well, gee, that's moving around a lot, when you take the lens back a little further and look back and smooth it out into multiple quarters, it goes right smack into the magnet of the $105 that we've been tracking to for years, frankly.

So, on that one over those two quarters, no, you're right this particular model didn't soften that. Reality though is, believe it or not, those spikes actually would have been more exaggerated just given market conditions and such that it would have actually been wider than $50 and $164.

It's not an improvement over the previous three, five quarters, but actually it was improvement over, because we run simulation testing all the time, and was an improvement over the old model that way. So again, on the longer…if we had the parallel universe of looking the old model new model, this new model does continue to actually raise the Sharpe and lower the standard deviation. Those two quarters that you'd pointed out, totally fair. But, when you look back further and we go back one, three, five, seven years, new model testing completely outperformed in every case.

**Rich Repetto**
Okay. That helps, Glenn. Then the next question, Nigel, just on the tax rate, can you tell…you had, I think you had given this guidance for the three quarters to-date and it varied. Is that because of the loss?

**Nigel Rose**
Yes. It's a function of the level of losses but also where those losses arise and then the impact of items that are deductible for P&L purposes but are not deductible for tax purposes. And those can move right around a little bit because you would think 19% in the UK, 21% in the U.S., you'd be around 20% ordinarily. On slide 23, year-to-date on adjusted basis we have the 16%, which I think we mentioned on the September metrics, so the GAAP between the 20% and the 16% would be due to some of those non-deductible items reducing the tax credit.

**Rich Repetto**
Got it. Okay. And an off-the-wall question, Glenn, you certainly have heard about zero commissions in the equity market. And I'm just trying to see whether any…I know your model is completely different. You're not in strict agency model, but has that even come up with clients in regards to the lowering of commissions in a different asset class?

**Glenn Stevens**
It's an interesting point, Rich. And of course, we've been watching that whole development unfold so quickly the way it did with such large players for a piece of the market, particularly in the U.S. One little side benefit that it's actually had is that there was a certain sense of, we can either call it mistrust or lack of understanding or discomfort, where actually customers not paying commissions in our business didn't sit well with some customers, you have new customers looking into our market, trying to figure out how to trade this market and it's almost like, "I don't get it. That seems too good to be true. I totally get it, if you charge me five bucks or ten bucks a trade, then it would make sense. What do you mean there's no commission?" And in trying to walk somebody through the whole concept of being able to have a bid offer spread and extract our de-facto commission on each trade by being the market maker, it's harder to explain than saying it's $7.99.

So, in one, in some ways, now we have others joining our challenge to explain to customers to say, "Well, yes, we're able to let you trade with us without commission," and they say, "Well, okay, I get it. But why?" And then we have to explain, security lending revenue and financing revenue and all that kind of stuff, not great and not easy. So, in some ways it actually adds credibility to our model, there you go, "I see, I see how a broker can be commission-free and still be completely above board." So that's an odd, but beneficial understanding for us as equity traders look at other markets.

The other part of it though is that, outside the U.S., we do have some commission-based products where people are accustomed to paying commissions, trading non-FX products. And in those cases, you have a situation where the spreads are so tight that they'll pay that. And we have yet to see any of the providers in that CFD business feel any pressure to adjust the models, but it is something we would have to consider.

My guess is that the pricing would just be adjusted. So, when you have this razor thin, that offer spreads that in these products that have a low commission, you probably end up with an adjustment that way because it's a little bit of a combination of “is it in the spread or is it in the commission?” And so, it ends up getting adjusted. But, in general, it hasn't created any negative connotation. I just wanted to highlight that one positive one because our relationship managers have provided some feedback to say, hey, people got this question and said like, “Oh gee, now I get it.”

**Rich Repetto**
Got it. And Glenn, I'm going to leave it to someone else to ask how October's doing to-date. So…

**Glenn Stevens**
Sounds great.

**Operator**
Thank you. And our next question comes from Kyle Voigt with KBW.

**Kyle Voigt**
Hi, good evening. I don’t have a question on October but just a question on the new direct accounts, they continue to grow, in that slide you provided there. When we see a number above, I think it's above 40,000 on this new direct accounts acquired in the quarter, but we only see you're trailing three-months active direct accounts increase by 3,000 in the quarter, I'm trying to figure out like what does that really mean or, it's one of two things. Are these clients just opening accounts and just not trading yet, or are you experiencing higher attrition rates than you have historically?

**Nigel Rose**
Hi, Kyle. I’m sure Glenn could weigh in, and it is a good question, It does take time for new accounts, once they've opened accounts to get used to the platform, going on fund, and feel that they are ready to trade and then put their own money into trading the markets. So that can be a slight delay.

**Glenn Stevens**
And I would mention that timing of delay, which we do monitor very closely, in quieter periods almost automatically stretches. So when it's really busy somebody open funds and trades in a very short amount of time and when it's low volatility or not as much of an urgency affect the time between submitted app through trading, which by the way in between there means approval and funding and traded extends out. Now, we can accelerate that by our own technology and efforts and investments. The ability for us to improve submitted app, but that doesn't help the timeline as much because we can't extract funds from somebody. They have to opt to fund, obviously voluntarily.

So, without that “now” factor in the markets that naturally extends itself, which we are seeing in this environment. So that's one factor. The other factor, I think, I would add also is that, some of the customers we're bringing to our market as we widen our audience and we've expanded our marketing does bring in slightly less intended or urgent customers who are seeking us because by natural selection when we cast a wider net, we ask people who say, “Yes, that is pretty interesting. I'll open an account," but what happens is they almost end up in our funnel of conversion efforts where we have outbound. So, someone on board put in an app, and this is nothing new for anybody who has shopped online for a vacation or a piece of clothing or whatever, where you get an email, that says, "Hey, we saw you were interested. What can we do to sweeten the deal or how can we get you to convert to a live customer?"

And so again, this concept of, number one, there are not being a market urgency, and number two going to a wider audience. There's a little bit more effort to get them to that trading level, of course, I would say that the funding percentages have held up pretty well, which is encouraging because submit on one hand, it's been a while, but we no longer tout, unique impressions. You remember that term. Everybody was using our online businesses unique impressions, like "Who cares, people are coming to your website, what are you doing to convert and then monetize them?"

So we moved on from there and then it was submitted apps. Yes, but if the quality of the submitted apps degrades, then that doesn't help you convert. We haven't seen that. That's actually holding up very well. And then from the percentages of conversion from submitted apps to approved apps has held well, because again, if your quality was low, people aren't properly well-versed, they're not of age, they don't have sufficient funds, whatever things that would disqualify them in various jurisdictions has held up well.

And then the funding percentages has held up. The part that's the challenge for us in these environments when it's quiet is getting converted to trade. So, it doesn't surprise me that that yield is lower. But what's really more important is that your hurdle to engage them and that's why I used the example of the oil. We didn't have a double or a triple, we had a 5x spike in oil. Now granted, oil is a small product for us and it was two days and it didn't have a demonstrative P&L impact obviously. However, it did show me that with a broader base of opened and funded and ready to trade clients when something happened that was compelling, and that happened on a Saturday and by Sunday evening we saw this huge spike that continued through Tuesday that show a bigger base of clients engaged.

And by the way, we looked at the numbers and it wasn't just existing customers that were with us for more than a year. Nearly half of the volume came from customers inside of one year. So even new people who hadn't necessarily engaged a lot and said, "Oh shoot, I have an opinion, I need to do something." So, I think that was really helpful.

And then, when you add on top of that kind of us trying to innovate a new product and that's why we highlighted the idea of saying, "here's a spot oil product that doesn't roll over like a future. It's just really easy to trade, it trades just like a currency, your bullish oil or your bearish oil, you don't have to worry about carry financing, end of contract life or anything like that." We can see that the response is really good. So, I use that as a microcosm, but the reality is as long as that potential value is there, which we're seeing by building all these funded accounts and that's why we tout the funded account. They're not open applications, they're not submitted applications, they're actually accounts that have been completely approved and are ready to go.

**Kyle Voigt**
Okay. And then, I think part of that question, I don't know if you directly answered or not, but maybe I'll more directly ask is, have your attrition rates increased, when you look back over the past 18 months or 24 months, has there been an uptick in attrition rates?

**Glenn Stevens**
It's been an uptick in attrition? No not necessarily. The rate of churn hasn't materially changed from what we've seen in... you're only seeing lower levels of customer attraction.

**Kyle Voigt**
Okay. And then just on the marketing, I think you have…maybe you didn't put it in this slide, but in last quarter I think you talked about very high IRR on the marketing spend and you highlighted as a good use of capital right now is continuing to invest in marketing. Just what assumptions are going into that in terms of, you just talked about these different types of clients maybe that you're casting a wider net. Is it possible that these clients may be a lot less active than your current clients, maybe less of them just even convert from funded accounts to actually trading or active accounts…assumptions are in that?

**Glenn Stevens**
No, it's a good question, Kyle. And the way we measure it as a couple fold. One of them is just time. And so, we're just coming up on our first cohort of a year's worth, so if in Q4 of last year someone is now coming up on their first full year with us, and if we are looking at a three year, we generally consider the lifetime value of our client to be mostly captured within three years.

Now the reality is we have lots of clients who trade with us more than five years and there's this long-tail of revenues it is almost 50% of revenues come from what we consider loyal clients, with a tenure of more than three years. But for the purpose of this marketing investment, we use a three year value as a total return aspect to reduce the IRR over that time...

So, we look at the amount of money, the amount of spend, the amount of return in a three-year period yields the IRR. The good news is that, that's held up continues to hold up above our expectations and pretty well, so in terms of the degradation of the quality of the client, no we're not seeing a marked situation there.

However, that to be fair, to truly measure it, we probably have to look out another couple of quarters to say, "Okay, when we had that first cohort that came in, let's call it a Q4 cohort," then it was a Q1 '19 cohort; Q2, it's hard to make a complete determination that early in the cycle too, when the reason being… I think I have a better answer for you, that if there were a plethora of trading opportunities and the returns weren't there then I would have to say to you, "Yes, you know what, because it should have been more active, they should've traded more than we should have generated more revenue we call CTR," client transaction revenue, thank you, I forgot that one. "But the client transaction revenue, it should have been there." But when you…we don't have that plethora of opportunities instead you have dark opportunities in, long-term low-vol, then you don't want to be quick to judgment to say, hey you're a quarter in or two quarters in. Well, first of all, it's two quarters over 12, and second of all you're in this pretty poor environment to be able to make a decent judgment. So, I'd say that based on observation, empirical evidence, no. And number two, based on subjective it is true to say, "Well, you haven't really even had a decent test that way." So, despite that, they're still getting some pretty solid returns in terms of an IRR on the investment. And that's where we actually mentioned that again in this deck that we still consider it a very rewarding use of capital for us.

**Kyle Voigt**
Okay. I have one more question and then I'll hop back in the queue. This one is maybe a little more unusual, but when I'm thinking about your business and maybe potentially other adjacent areas where I have like your regulatory status scale, trade technology, user interface, could be useful. One that comes to mind is online and mobile sports betting and another broker in the

space, I think IBKR, launched a simulated sports betting application recently. My question is, would there be any desire for GAIN to build-out something to address that kind of growing sports betting market in the U.S. directly, or even licensing some of your technology or partnering with someone in that space or is that just too far of a leap?

**Glenn Stevens**
No, it's a really interesting question, and we have spent a fair amount of mindshare internally reviewing it, looking at it with partners, it's amazing, frankly, to see how much of a magnet it's drawn. I don't think you can listen to a radio or watch television, haven't seen it inundate online yet, frankly, but certainly on TV and radio in this Tristate area, you can't go 11 seconds without somebody hitting you up with a customer bonus. And in our business to be able to track a lot of these marketing activities, we're very accustomed with it and it's amazing how similar they are, they're deploying frankly, financial services, models to say, "Look here's how you refer a customer, or here's a signing bonus, or here's a way to make a trade de facto, but not lose any money on it." All these kinds of things are amazing and I'm not so sure FINRA or the CFTC would be all too pleased, but neither of those entities regulate sports gambling.

And so short answer to your question is, yes, we very much have considered it and it was interesting to see IBKR, if you will. Also, to note some of our U.K. based brethren in the past actually had pretty sizable sports betting operations and most interesting spent up until about five years ago, seven years ago, is very much as a part of their business, and then exited it because there was this arguable tarnish, that said, "No we're for investors and so we're not going to get into sports bedding."

And yet you see very reputable firms now circling back and say, "Hey, if that's what you want to speculate on with all these tools and all this technology, it's much more than just a guy on the street corner taking a bet for you and giving you a slip of paper." Then, my answer to you is, I don't believe it's outside of the realm of possibility. We do have a lot of technology and expertise in the space. However, it does appear that some of the private equity-backed shops and some of the other on transports…some other locales have really flooded this market, it would be interesting to see if the table to support all of them because there's got to be 15 right off the bat, 15 pretty big providers for just at least for now, Pennsylvania, New York and New Jersey…really just Pennsylvania, New Jersey market. So, but look, to be fair, particularly in the U.S. it's highly likely this becomes multi-state like EZ Pass pretty quickly. So, it wouldn't be a terribly hard pivot for us and it's something that if it's done in a way that we think we can add value and differentiate, I don't think it should be off our possibility list.

**Kyle Voigt**
Okay. Thank you.

**Operator**
Thank you. And once again as a reminder, please press "*" and then "1" if you would like to ask a question.

And the next question comes from Ken Worthington with JP Morgan.

**Ken Worthington**
Hi, good afternoon. We've seen losses three out of four quarters, there's clearly a lot of pressure on the business. How does the consolidation environment look right now? So, as you look to your smaller competitors or the competitors in parts of Asia and Europe, I assume the

pressure is fairly intense on them as well. Are those competitors closing shop, does it make sense to acquire that customer base? So, what is your appetite for transactions right now?

**Glenn Stevens**
The appetite and the ability remain…because we have a track record of…I would argue successfully assimilating acquisitions over the last decade. It does give us comfort and faith that when and if they make sense, we would be able to move forward and do something about it. Number one, maintaining a fair amount of cash dry powder, number two being operationally willing and able to do those deals because by the way sometimes people are financially able, but operationally again they get mired and for that's handy.

And we certainly have pockets of opportunities globally really would make sense too. So, regions like Southeast Asia and the Middle East and Latin America and even certain parts of Europe where we're not particularly strong yet. I would argue that it's a step function ability to get into those markets. The good news is that with a prolonged period as you mentioned of challenges in this environment, it does make for a more reasonable value discussion when you're having these discussions with people. However, in some ways when you buy another business, we're pretty good at being able to price the assets of another business. But when someone wants to sell their intrinsic, what they consider their intrinsic, value in technology or market positioning or what have you, that's a hard discussion because for us we feel like, it's a two pressure.

One pressure is prevailing market environment in the present. The other pressure is the regulators who actually create a benefit for larger, more stable, more solvent providers like ourselves. And so, in some ways the marginal players who are deploying very aggressive tactics or very thinly capitalized or not really providing the proper infrastructure for an on the boots organization. I'll give you an example, even have outside policemen like Google determining that if you don't have a license in a market, you can't be found in a Google search in that market. So, let's use Canada for example. Unless you are properly licensed there only recently Google shut down advertising there who decided to flout the local registration and they tried to attract clients like that.

Well the good news is for us is that we become part of a very small group that can provide these services there because we are properly registered and licensed and all those people we were competing with who didn't have any, audits that came from [indiscernible] and capital requirements and staff and such were competing with us at a very low-cost basis. Now, they can't because the regulator does what they can, but it really helps and Google says, “Well, no, we're just going to block your content.” So, that's good examples, we don't need to buy that shop in that business there because we're going to get that business going forward. I'm not saying it's a huge market opportunity, but what I'm saying is, it's an example clearly of other outside pressures forcing some of the marginal players out.

So, I think that we do have very open and active in discussions where it makes sense strategically, but there's also a bit of a positive coming our way. And I'll add to that, on being well capitalized does help short-term challenges when it comes to making money, losing money even on a cash basis, making money, but on a non-cash basis or net income basis, when you count [indiscernible] and others losing money, but it doesn't mean that we're also not finding ways to lower our breakeven. We continue to do that. Actually, if you compare our present financials with one, even a year or two ago, we're at…by managing our cost effectively and if you'll notice we continue to come in on the lower end of our…every time we give our cost guidance, we come in on the lower end of it. That's not a desire that's going to go away for us.

**Nigel Rose**
Yes. And just to add Glenn when you said, we focus on overheads, but if you look at our income statement now, you'll see D&A has come down because we've been conscious about our CAPEX spend and reduced that over the last couple of years. So, that's flowing through into D&A number. And as we mentioned earlier, repurchasing the converts that then reduces the interest expense. So, we're looking at every line we can in the income statement to see how do we get those to a level that in conditions where the ADV is $7 billion that we can be fairly confident we'll have a positive net income.

**Glenn Stevens**
With the idea being that is the storm, you can't determine how long challenging conditions prevail. But we want to be able to be in a better situation, so that when the weaker providers continue to suffer [indiscernible] or they can't compete with you anymore. So that's why it's got a benefit that way too.

**Ken Worthington**
Okay, okay, great. Thank you. Thank you very much.

**Glenn Stevens**
You got it, Ken.

**Operator**
Thank you. And the next question comes from Raj Sharma with B. Riley FBR.

**Raj Sharma**
Hi, guys. Can you give some color on the market making this quarter as a proportion of total trading? How did it trend versus the volatility that you saw last quarter versus this quarter in the the CVIX [indiscernible]?

**Glenn Stevens**
So, just to confirm, are you talking about Q3 versus Q2?

**Raj Sharma**
Yes. Q3 versus Q2, just, how the amount of market making you do versus unidirectional trade, and it reflects some of the revenue capture. Can you talk about what proportion of the total trading was market making? And also, if your AI-related hedging model is helping you with the market making proportions and the RPMs?

**Nigel Rose**
Hey, Raj. It's Nigel here. Are you saying how much of the activity we saw in Q3 was customers naturally offsetting each other versus the [technical difficulty] exit? We haven't disclosed that at this stage. I think in the Qs and the Ks we have that statement around I think it may around 95%, 97% is either naturally hedged or hedged to brokers and this quarter was no different to that.

**Glenn Stevens**
And keep in mind that from a market making perspective, if you will, you used the word unidirectional, I just want to clarify, there isn't any directional market making within our business or within our capacity. So, 100% of everything that we do is facilitating customer hedging. Now, whether that's done as we said instantaneously, or not, then I just wanted to clarify, the

unidirectional aspect doesn't exist. But, in terms of what portion that, remains pretty much high. The difference here, most importantly, that drives our RPM capture, if you will, our market making piece is the propensity for customers to have two-way trading.

And what we mentioned, for example, in Q1 when you had very narrow ranges but actually very well-defined ranges, you get very little bidirectional trading because it actually, let's use your word in different context, maybe, you get a lot of unidirectional trading because when the Euro was trading in a super tight range that repeats itself over a quarter, you get the preponderance of your customers all selling at the highs and all buying near the lows, which means our ability to capture offsets or internalization is very low. So, we ended up having to do a lot of real time external hedging, which means your spread capture is lower. When you have less defined ranges and more two-way trading, even with the same kind of volume, it's just a different nature, you end up with a $164 instead of a $50 in terms of an RPM. So, maybe if I phrase it that way, when you look back, it wasn't so much the nature of our market making versus anything else. It was the nature of the customer trading that defines the difference between a $51 and a $164.

**Raj Sharma**
Okay. Thank you. And also, the hedging model that you're talking about using AI, I see that the standard deviations of the daily revenues is going down and does this help you in reducing the quarterly variability of RPMs going forward?

**Glenn Stevens**
So, it's good you asked the question because it's a little bit, with the question I came up earlier in the stream today. The key part is what you said about quarterly because one of your colleagues said, "Well hey, I see that the Sharpe ratio is improving because it's going higher over time. And I see the standard deviation of daily P&L is going down, that means improving because it's less variable. But, why the hell did you have this big difference between $164 and $50?" And the first thing I highlight is to say, "Well, yes, in those two quarters that those are variable, number one, I'd point out that they go right smack through our long-term average of $105, then you add $164 and $50 and divide it by two," or pretty close.

And then, over longer term this AI model is not necessarily designed to reduce quarterly variability. It's designed to reduce overall variability meaning over a year, over 16 months, over two years. So, we've been running these parallel testing since Q1 of '18. And by every measure in the last, let's call it 18 months, if you go from Q1 of '18 to now, so roughly 18 months, all of the measures show that we would have had a higher standard deviation of daily P&L, and we would've had a lower Sharpe ratio if we started using our new model. So, it has improved, and I guess the one thing that we can't show you is to say oh, by the way the difference between Q3 of '18 and Q1 of '19 would have been even greater if we weren't running the model.

**Raj Sharma**
Got it, got it. I understand, I will take it offline now. Thank you.

**Glenn Stevens**
Yes, sure.

## CONCLUSION

**Operator**
Thank you.  And that does conclude the question and answer session as well as the call itself. The conference has now concluded.  Thank you for attending today's presentation.  You may now disconnect your lines.