GAIN Capital

Q2 Earnings Conference Call

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CORPORATE PARTICIPANTS

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Nigel Rose - *Chief Financial Officer*

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PRESENTATION

Operator
Good afternoon, everyone, and welcome to the GAIN Capital Second Quarter Earnings Conference Call. Today's call is being recorded. At this time, I would like to turn the call over to GAIN Investor Relations representative, Lauren Tarola, Senior Accounts Supervisor, Edelman. Please go ahead.

Lauren Tarola
Thank you, operator. Good afternoon, and thank you to everyone for joining us for our second quarter 2017 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 the 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 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 slide. 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 Lauren, and thanks to all of you for joining us today for our Q2 review. Improved market conditions, expanded trading ranges, and increased customer engagement resulted in a strong quarter.

GAAP net income of $13.9 million is up 29% year-over-year and GAAP EPS was $0.31 as compared to $0.19 from the prior year period, although both increased in part due to a one-off tax-related benefit. Despite a decrease in Q2 revenues as compared to the same period last year, adjusted EBITDA margins and adjusted EPS remained stable due in large part, to our cost reduction initiatives. This demonstrated GAIN’s continued success in driving operating efficiencies and margin expansion.

Operating expenses for Q2 decreased 11% year-over-year and were down 12% for the first half of 2017 as compared to the same period a year ago. As announced on our Q1 earnings call, we continue to execute on a fixed-cost savings program to reduce expenses and grow margins. Consequently, we remain on target to achieve $15 million in fixed cost savings in 2017, which will translate into a $20 million run rate for 2018.

As we saw a significant improvement in our quarterly retail revenue capture of $122 per million revenue capture for the trailing twelve months ending June 30th is now $106. This is directly in line with the same period last year and in Q2 of 2016. This consistency is important to note because, although we will have variability quarter-over-quarter, when analyzed on a trailing 12-month basis, our results tend to normally remain just above 100. This has enabled us to focus on maintaining financial flexibility and return capital to investors through our share buyback, which we believe is the best use of capital at this time and appropriately delivers value for our shareholders.

During the quarter, we repurchased over 760,000 shares, which is a 24% increase over our buying activity in Q1. Year-to-date, we have repurchased nearly 1.4 million shares. And as of quarter end, we have approximately 15.1 million authorized and remaining for additional repurchases going forward. In total, for the first half of 2017 we returned $15.2 million to shareholders through the combination of stock repurchases and dividends.

In order to drive continued growth, our business strategy remains centered around executing on the combination of our organic initiatives, complemented by strategic M&A. First, looking at our organic growth strategy, we continue to focus on investing to drive increased client retention and acquisition through three main drivers: growing share where we already operate; enhancing our technology to introduce new products and services; and improve our customer experience to include easier on-boarding, education and providing actionable content.

During the second quarter, some examples of the progress we have made include a newly launched City Index UK and FOREX.com website. Upgraded mobile trading apps and the global rollout of our FOREX.com active trader program. In addition, we continue to automate and streamline account opening by enhancing the on-boarding experience of the City Index platform.

We introduced e-wallet as a funding option for our clients in the AsiaPac region. And we have automated know-your-customer checks for instantaneous approval of accounts. Following the recently successful launch of our cross-brand affiliate marketing program in the UK, we are now rolling out the program across other major regions in the second half of this year. And at this lower-cost acquisition channel, will allow us to tap into new audiences effectively.

Lastly, digital advisory is a focus area that we believe will differentiate us from other competitors and will be more attractive to those clients who are looking to actively participate in the market. We will also be rolling out an innovative mobile-only trade signals app later this year.

Shifting to the M&A side of our balanced strategy, we have a strong pipeline of M&A opportunities currently in review, which are focused on several key objectives.

First, expanding our product set by adding new products within existing lines by partnering with startups or other Fintech companies to leverage innovation.

Second, we will pursue opportunities that provide additional distribution channels by accessing new platforms for other technologies favored by select customer groups.

Third, expanding our geographic reach and scale by accessing markets where we do not currently have expertise, personnel, or require regulatory permissions, and possibly acquiring strong local brands.

Finally, our fourth key M&A objective is to complement our existing products and services by adding new types of business lines that are complementary to our core offerings. While leveraging acqui-hiring opportunities to add new talent in those specific areas. We remain well positioned to capitalize on opportunistic growth prospects as evidenced through our purchase of FXCM US client assets in the first quarter.

In addition to being disciplined in acquisition review, and execution, GAIN also has a strong track record of successfully integrating new platforms and driving cost synergies.

I also want to highlight that regulatory change and market dislocation continues to produce M&A opportunities for us. Having successfully delivered on integration cost savings during the past few years, we are staying focused on our expense base and reducing costs in 2017 and beyond as outlined in our Q1 call. We remain on target to achieve $15 million in fixed-cost savings in 2017 which will translate into a $20 million annual run rate for 2018.

We will continue to identify areas for savings over the next few years as we seek to further lower our operating expenses and margins.

We expect to deliver a targeted 35% adjusted EBITDA margin. The resulting improved adjusted EBITDA over that period coupled with disciplined management of capital expenditures at approximately $3 to $4 million per quarter will ultimately generate significant free cash flow and ultimately drive additional value for our shareholders.

Before passing the call to Nigel to discuss further our financial results, I would like to give a brief overview of the regulatory landscape. Historically we have seen that regulatory change can be beneficial to both customers and industry participants. Our hope with all regulation is that it strikes the right balance with rules that help increase protection for retail investors, while leveling the playing field for providers.

GAIN is highly focused on protecting our customers and therefore, we welcome and support global regulated efforts to increase protection for retail investors and ensure customers have access to products and services that are commensurate with their financial experience and risk profile. We believe it is imperative to level the playing field for all brokers operating in our markets. Adapting and assimilating with regulatory change is a core competency for Gain Capital. And we have in fact thrived under these conditions and continue to grow. With that, I will turn it over to Nigel for a financial revenue of our second quarter and half-year results. Nigel?

Nigel Rose
Thanks Glenn. Revenue in the quarter was $98.1 million, down 9% year-over-year. Despite this decrease in revenues as compared to Q2 2016, adjusted EBITDA margins and adjusted EPS remain stable due to our cost reduction initiatives with operating expenses down 11% year-over-year. Q2 adjusted EBITDA of $26.5 million was down slightly from $27.6 million in Q2 2016.

Due to a one-off tax related benefit this quarter, adjusted EPS was $0.25 compared to the GAAP EPS of $0.31. Our quarterly average daily OTC trading volume was $9.9 billion in retail. Whilst 9% below last year, this represents a 4% improvement over the first quarter. Our institutional segments so quarterly average daily volume improved to $13.2 billion, a 20% increase from $11 billion last year, driven by strong performance in our ECN platform.

Turning to the retail segment, during Q2 we realized revenue of $80.6 million as compared to $89.4 million in Q2 2016. Reflecting the success of our ongoing cost reduction initiatives, retails profit margin improved to 38% during the quarter, up from 35% in Q2 of 2016 despite those lower revenues.

During Q2, overall retail client assets increased 14% year-over-year to $732.9 million, benefiting from the integration of FXCM accounts. Following the anomalous Q1, Q2 RPM improved with capture at a $122 per million as we saw improved average trading ranges and event-driven volatility such as the French elections.

Despite the recent quarterly fluctuations in our RPM, we continue to emphasize on the need to look at this metric over a longer period of at least twelve months. By way of an example, RPM for the trading twelve months of June 2017 of $106 was exactly as the same as that for the 12 months to June 2016.

Active accounts on a trailing 12-month basis was stable year-over-year, however, direct accounts active during the quarter were up 23% year-over-year including the impact of FXCM. Average daily volume fell 9% with the prior year benefiting from the Brexit referendum volatility, but is above the trailing 12 months $9.6 billion.

Our focus on partner optimization whilst improving margins has seen indirect volume decline with further terminations towards the end of the last quarter. This is master growth in direct volume, which increased 11% year-over-year and is up 20% quarter-over-quarter. The combined effect of this means indirect clients now account for 31% of total volume this quarter compared to 42% in Q2 of 2016.

Turning to the institutional segment, revenues were $7.7 million for the quarter, up slightly from $7.5 million in Q2 2016. Our ECN business saw a 36% increase in average daily volume year-over-year coming in at $11 billion and is above the trading 12-month average of $10 billion as it continues to grow market share. Changing customer mix over the year has meant that the ECN volume growth translated to 23% revenue growth. However, we expect revenue capture rates with ECN to stabilize going forward as that mix settles.

Swap dealer average daily volume decreased in Q2 to $2.2 billion, again due to changes within customer mix. Recent transactions in the space have validated our initial hypothesis as we invest in our institutional business, which we believe will add significant value on top of our retail segment. In the futures segment, revenues were $10 million for the quarter, down from $12.9 million in Q2 2016. Mix declined year-over-year for both the quarter and the first half of 2017 as it continues to operate at multi year lows.

For the quarter, mix was 20% lower than the prior year, whilst for the half year it fell by more than 40% compared to the first half of 2016.

Our low fixed-cost prices helped to manage such circumstances and mitigate the impact on profitability. In the first half of 2017 expenses were $20.1 million, down 10% as compared to the same period in 2016 and Q2 expenses were $9.4 million, down 15% from Q2, 2016.

Client equity fell year-over-year as some customers traded our positions causing minimal impact to revenues with a disproportionate drop in client equity. Our capital deployment strategy is aimed to increase shareholder return and actively manage risk with a focus on four key pillars: required liquidity reserves, strategic acquisitions, quarterly dividends, and our share buyback program.

GAIN continues to maintain a strong liquidity position which as of June 30th was $135.8 million. In addition, we are pleased to confirm the securing of a $50 million revolving credit facility expandable up to $75 million. We now have even greater flexibility within our balance sheet to capitalize on future acquisition opportunities as they arise. This coupled with our organic growth initiatives is the core growth strategy for GAIN in the long term.

Actively returning capital to shareholders remains a core priority for GAIN. Two of the ways we look to achieve this is through both dividend payment and share buybacks. A quarterly dividend of $0.06 will be paid in September, and share buybacks continue to be a strong focus, particularly as we feel like shares remain undervalued.

During the quarter, we purchased over 760,000 shares at an average price of $6.24. At quarter end this left approximately $15.1 million of authorized funds remaining for future opportunistic share repurchases.

I will now turn it back to Glenn for closing remarks.

Glenn Stevens
Great. Thanks Nigel. Before we go on to questions, I would like to reiterate our go-forward plans plan for the remainder of the year and beyond. Despite volatility of earnings results over the last few quarters, we've remained very optimistic about the growth prospects for our company and believe that our status as a large global leader in a multi-asset trading space and highly diverse and scalable business model positions us well for future organic and acquisition-driven growth.

The combination of investments and our customer acquisition and retention efforts as well as opportunistic M&A and integration will continue to be the cornerstones of our long-term strategic plan for growth. As demonstrated by Q2 operating results, we continue to execute on our long-term costs reduction plan and will look to identify other areas where we can improve efficiencies going forward. Our dedication and focus on optimizing capital allocation to drive shareholder value may gain attractive value proposition for investors.

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

QUESTION AND ANSWER

Operator
Thank you. We will 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. To withdraw your question, please press "*", then "2." At this time we will pause momentarily to assemble the roster.

And the first question comes from Rich Repetto with Sandler O'Neill.

Rich Repetto
Yes, good evening. I guess, Glenn, the first question is on the volatility of the RPM, I know the average is 106 over the last 12…trailing 12 months but have you been able to…or could you explain why it's been so volatile quarter-to-quarter, when we thought that the City acquisition would actually smoothe volatility in the revenue capture?

Glenn Stevens

Hi Rich. Fair question. I don't know if we actually expected City to smoothe out some of the volatility quarter-to-quarter, what we actually hope was that it would diversify and raise the overall RPM because of their heavier mix on non-FX products. And generally speaking products like equity indices and products like metals and energy as such have a higher RPM, and so ultimately the goal was to raise it. The difficulty over short term is when those…when those volatility curves as much as I hate quoting it are north of 20-year lows and things like the VIX, which are non-FX, when…that doesn't help.

Now you are right, the VIX hasn't changed before you say it. The VIX hasn't changed quarter-to-quarter so much to drive some of that, but the reality is over the short term, when you get the combination of the volume and the combination of the trading ranges. So again VIX is one component but as you've heard you say the combination of VIX, the combination of trading ranges, and in the combination of events that can driven it, Q1 was actually quite devoid of events.

Q4 had a few with elections and Brexit and such. And Q2 had a few, which we refer to the French election and some others. So, Q1 in particular as much as the 122 for Q2 is high it's…I guess I would argue, less anonymously high than Q1 was low. Juxtaposed next to each other, it exaggerates the volatility because it was outside the general cluster Q1 was at 62 or 63. And then the 122 we've actually seen a couple of those If you happen to look back on the slide that shows the 23, which shows the RPM, there was 124 there was 1 above that. The 63 stands out even past Q2 of '15 that was like a two-year one. To be honest not to call it a perfect storm but the Q1 was definitely a confluence of several factors that drove that one out.

So I guess I push back to you and say, if that number was more like at 80 and this 122, it would still be volatile but they'd be clustered. It just so happens that a particularly low one was next to a rather high one so they're exaggerating both ends. There is no other driving reason, and I guess more importantly there is nothing in our mix now that is tending towards or portending a higher level of volatility quarter-to-quarter.

We keep pointing back to the 12 months and the two years but even quarter-to-quarter, there is nothing we are seeing in our book that says we should repeat 60-120, 60-120. It should over time actually narrow there at kind of that 106. So that, if you look at kind of even Q…if you look at the 62 even putting it into the 106 and you go backwards Q1 and Q4, that also is at 106, and they were wide apart by the way. A high 104 and a low Q1 those also clustered to that same middering point.

Rich Repetto
Got, it. Okay, thanks Glenn. And then…..

Glenn Stevens
But I just want…but sorry, I was just going to say that so sorry for the long but to takeaway really is that nothing has changed in our book or even our customer mix or levels of engagement or product mix that says we should see repeats of 60 -120 they just happen to line up.

Rich Repetto
Okay, and then or call it 60 - 150 or so but anyway, so next question, Glenn, it would be on FXCM. Can you give us an update? You had 13,000 I believe active accounts last quarter out of the…I guess so potential 47 is we are at sort of the migration sort of peak with FXCM?

Nigel Rose
Yes, I am jumping in on that one. No, I mean we continue to see those customers grow but as you probably expect when they first come across that's likely to be when you are going to get in the biggest step up in actives and after that will be incremental changes. We continue to see the cumulative number of activated FXCM accounts grow. It continues to remain in line with our expectations and in terms of this was a revenue 15 million to 20 million. It's…we are trending roughly in the midpoint of that at the moment based on the five months that we've seen from those accounts.

Glenn Stevens
I guess I would add, Rich, that again what we modeled out in terms of 75% of the active assets, so in other words those assets that were active previous coming to GAIN, 75% of them are active with GAIN and you could argue that this is an expected step down doubled from Q4 in that one, it's a quarter and two quarters later and two, those assets were active in a very active period for Q4.

So, the double whammy, if you said there is 25% haircut and arguably half of that 25% was because we are two quarters later and half of that haircut is from Q1 and 2 not looking at Q…like last Q4 it's in line with our modeling. The other important piece though is that from the economics on this deal we are still tracking for that revenue guidance that we gave is on track and also from the…from what we paid FXCM we are already in the black on that deal and that's tracking again to our benefit.

Rich Repetto
Okay. And I guess my last question a little bit maybe more difficult. But on the segment results that you published in the deck that you put out, the expenses that you put up for each segment, the retail, institutional and futures segment. And I…we like to look at them quarter-over-quarter as well as year-over-year, which you present, but if you looked at quarter-over-quarter each of the segments went down and in total the segments that you reported on pages 10 and 11. They went down by like…if I get my math right like 3.4 million quarter-to-quarter 1Q, '17 to 2Q, '17 but the expenses that you've reported on the income statement quarter-to-quarter were just down slightly like 0.4 million, 80.6 to 80, anyway long way of asking is there the corporate segment, where did the expenses sort of increase to offset these segment expenses that went…looks like went down quarter-to-quarter?

Nigel Rose
Yes, you are right. So, when you look at the segments so as you got retail, institutional and futures, the bit that we don't show there that it's in the slide of the appendix is the Corporate segment, which then gets you to the total expenses you see in the income statement. And yes you are right, there was a bit of an increase and there is moving parts within the lines so for example bonus provisions were slightly higher in Q2 because we had a better Q2 than Q1. And one might argue if we had a crystal ball and we knew in Q1 what the half year would look like we have done a bigger provision in Q1 so that kind of skews the picture a little bit. There's a couple of other sort of revenue related items that does…do that as well. And then the remaining or moving part if you like is some of one-offs professional and legal fees that we saw in Q2, which will not be reoccurring and didn't feature in Q1.

Glenn Stevens

I think the key there Nigel you mentioning earlier was if you stripped out some of the kind of anomalous or non-recurring items then the…their expense quarter-over-quarter comparing apples-to-apples did improve….

Nigel Rose
It did.

Glenn Stevens
As we tried to highlight in our commentary. But again factoring in the corporate which will move around based on the timing of where you apply those expenses, it's a small enough number where it will actually….

Nigel Rose
Yes, and as a needle, and those expenses are set up on slide 22. And you can see Q1 2017 is $47 million going up to almost $51 million in Q2. If you normalize out some of those revenue-related bonus provision items, strip out the one-offs that we saw in Q2, the sort of underlying run rate there would have read $49 million in Q1, $48 million in Q2. So the underlying cost base is coming down, it's just there's a little bit of noise quarter-to-quarter as well as those one-offs that I mentioned.

Rich Repetto
Okay, that's helpful. Thank you, Nigel.

Nigel Rose
Sure.

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

Kyle Voigt
Hi, good evening. A couple from me. So I guess the first one would be really on GTX. Just given that the competitors institutional platform recently sold for over 20 times trailing 12 months EBITDA, just wondering if there's changes you are thinking on the strategic importance of GTX within the Group and whether changes you are thinking and whether this is a good time to monetize this asset for shareholders?

Glenn Stevens
So, we certainly, read much of the same industry information that that you just referred to and we have been conscious of even those kind of discussions and developments even before they become official, if you will, being conscious of what's going on in our space. And look the reality is that for us having somewhat some validation in our investment and business-building thesis where several years ago we said an institutional platform is a proper extension of our existing business I would argue that some of the parts and segments hasn't achieved the benefit that we thought we would get to this point in terms of valuation.

And so, I guess short answer is absolutely to consider opportunities in situations and the reality is that it's most important for GAIN to have access to those product in FXCM and the GPX business has flourished as part of GAIN or could arguably flourish outside as well.

So being able to unlock the value in that is always part of our discussion and when you get hard validation, this is the most recent one but arguably there has been three. The 360T transactions you know, less than two years ago. The hotspot transaction last year and now the Fastmatch transaction, all I would argue with credible buyers, certainly should add some validations to our GTX strategy. What we do at this point, is part of our, if you saw on our slide active pipeline, active M&A review that doesn't just mean for retail I mean for all our businesses.

Kyle Voigt
Okay. Fair enough. I guess the second question is probably still around M&A, but you outlined some of the areas that you might be looking at in terms of M&A. I'm just trying to get a sense of you know, when you outline the liquidity in your slides what kind of strikes me a bit is: this the regulatory capital and it's increased from $113 million in December to $138 million in June and we haven't really seen an uptick in your client assets over that time. So what's driving the increase in the US and the UK and what's the outlook there. Should that continue to stick higher?

Glenn Stevens
Nigel can opine on some of that, but some of it has to do with customer's position because different locales have different rules. Some of them are driven as a percentage of customer assets, some of them are driven as a percentage of customers open positions, some of them….So each regulator takes a slightly different approach. And so sometimes what will drive it up or down, so you can have a situation where customer assets go up and the reality is that customer assets go up but if clients aren't engaged, you would see our regulatory capital go down and you will say, well, I don't get it. Well, that's actually a bad thing, we want that number to go high if we can because it means our customers are more engaged and the regulator in kind will say, you need to have more collateral committed to cover their engagement, if that makes sense.

So and the reason why it's not a strict interpretation is because sometimes it can depend on the type of product. It can depend on the classifications the customer as a professional or non-professional, it can…have to do with volatility in those markets. So, for example, you've seen the CME change their margins for certain products when there is a spike involved. The same thing happens in the OTC market because we will have a commensurate change. So the fact is it's going to move around a little bit, it's not necessarily linked.

Over time, it will be linked to our customer assets but just like quarter-to-quarter RPM, quarter-to-quarter redcap moves around based on their...a lot of has to do with their position. So that's going to move around but over time if you have more customer assets then generally you should have more redcap required unless the rules change.

I don't know, Nigel is here.

Nigel Rose
Yes, I know that's right combination has different rules in different jurisdictions, just I mentioned there in the US, the customer assets…as far as the customer assets can have an impact in the UK and the US it's the size of the positions that we have, will have an impact so if you see regulatory capital requirements grow then, potentially that's a good thing because it shows, as Glenn says, plan engagement. More customers are holding positions with us and trading the markets but that doesn't mean to say, it's not scalable and the new revolver clearly will help us with liquidity and dry powder for M&A over and above any sort of redcap requirements as they move around.

Kyle Voigt

So the $136 million of liquidity that you outlined, how much of that is actually real free cash. I guess you want to keep a certain level of working capital or operating cash or liquidity on the balance sheet, so how much of that is actually real excess cash that you're comfortable either putting in work through M&A or buybacks or some sort of capital deployment?

Nigel Rose
Sure, sure. Yes, as you say, there's $136 million there and you sort of mention to have the regulatory capital requirements to move around. So we need to make sure we've got sufficient buffer for those type of movements. So internally we tend to look at numbers being $70 million up until today with the revolver in place you know, potentially that can now increase and potentially double but historically it's been around that $70 million mark.

Kyle Voigt
Okay, okay and then the last one from me and I'll get back in the queue, it's just really on the regulatory topic. Glenn, I know you touched on it in the prepared remarks but I want to just dig in and get a bit more clarity because in June, as was stated, that I was considering implementing these new regulatory measures for CFD and spot FX trading including potential leverage limits and restrictions on marketing as well.

So I guess the question is if you give us some updated thoughts on expectations from ESMA that the FCA I guess is kind of backing off a bit and waiting for the ESMA results or proposal. And then, what's the com and I guess what's the potential timeline going forward?

Glenn Stevens
So it's actually pretty interesting to follow developments as they are now becoming more and more politicized in my opinion than they have been in the past. I think pre-Brexit it was clear to us that the FCA was working almost as a independent regulator taking the pulse of the market, taking input from providers, taking feedback from participants, meaning customers, other regulators what have you and trying to sort out next steps going forward being a real kind of proactive regulator and knowing their salt pretty well.

How that mix has changed to some degree is that ESMA I would argue was pretty much in the background, almost letting the FCA be their clear lead in that product. And then, kind of post Brexit, have now stepped up to be much more vocal and you know, we have had direct conversations with both regulators on a regular basis.

So we are happy about being engaged as a global provider, and that's been really good. And so you know, working with ESMA, it does appear they are going to be thoughtful. They are looking at what each European regulator has done at least or proposed on their own trying to come with some kind of coordinated effort and now you see the FCA and ESMA also working in tandem, which again I would argue didn't happen in the past. And so in terms of just how it's playing out, there are more variables of play, more players involved, there does seem to be a willingness to involve the biggest global players as part of the dialogue, as part of the research, and as part of kind of a two-way communication. Timing wise, which you have referenced. Yes, stop testing it and put it on hold. I think if you go backwards to this time last year there was a little bit more of a speedy timeline that said, hey, by Q1, we are going to have some decisions and then the reality is that we have definitely seen that get pushed back twice in the FCA and now it feels like it's part of a bigger process. I think you will start to see some impact in Q1 of next year, I don't think it's just going to rollout like a [indiscernible] and say here is the new rule, nobody kind of propped us you know, kind of scenario, it's going to be, I think we will start to see phase-ins in Q1 whether it has to do with introducing brokers or you know, certain types of payment for a flow of relationships or pass-porting for outside EU or how they coordinate with UK shops so we will start to see that phase in I believe, we believe in Q1.

The good news is that for GAIN given our experience, given our size, given the liquidity, I mean all these things come into play we're actually well positioned. And so it wasn't a throwaway in my prepared remarks where we made mention of saying that not only are we encouraged by a more proactive regulatory environment, we think we are well-positioned to thrive in it. And I mean that's a core competency and something we've actually shown over the last decade that we've adapted well too and now that we are even more kind of local and central to different regulators globally, we think it's a good benefit for customers and for the industry providers.

Kyle Voigt
Okay. That's it from me. Thanks.

Glenn Stevens
Thanks Kyle.

Operator
Thank you. And the next question comes from Dan Fannon with Jefferies.

Dan Fannon
Thanks. I guess the adjusted EBITDA margin target of 35% can you give us a time period or kind of a framework on how you think you can get there and as I said the time period for which is reasonable to assume?

Glenn Stevens
Oh, in an hour Dan.

No, so a couple of things. On the one hand some of the similar things that we've seen drive our short-term EBITDA margins like volatility, like customer mix, like product mix obviously can accelerate or decelerate that delivery time period over the short-term, but in terms of my reference, particularly in the slide where it stated, you know, we put a two-year time frame in there. It's certainly several quarters and there is a few drivers of that. Number one, moving past what I would call the integration and synergy capture phase, where we had…we've been guiding our investors towards the progress and the capture of that $45 million of synergies. We have then kind of embark not to say okay we are done the company is fine in terms of cost structure and organic growth and M&A growth.

No, we then said, you know what, synergy now is arguably BAU, business as usual our BAU should not reflect kind of the 20%, 25% ranges of EBITDA that we've seen in the past. Instead, 27% with for Q2, obviously we had other ones that we've seen for example retail alone was high 30s of the Q1. So the 35% associated composition of what our business will look like a year or two from now as we attack our cost base, because beyond synergy we think there is opportunities for further migration in terms of platforms of retirement and streamlining. There is our ability to get other units globally more in line with more cooperation. And then, there is a growth piece that comes from it. We have some things we are excited about in the pipeline in terms of product and in terms of geography that we think will help that way because to us we definitely think this is going to be a parallel effort of lowering our cost base, which is why we mentioned the $15 million for 2017, which will translate into $20 million for 2018 complemented by some growth initiatives that will help.

Again, over the short-term are we subject to some variability or the vagaries of market conditions? Yes, but that's why over a longer period we are saying regardless of how conditions payout, we will be at a better curve for that. And we are targeting that, because we think that reflects almost a very achievable and almost at a minimum where the business should be if we are structured properly and running more efficiently than we are now.

Dan Fannon
Got it. And then, customer turnover is and, or I should say retention client retention is part of your organic growth initiatives, and I guess if you could just kind of update us on some of those metrics and maybe compare versus previous periods but also as the FXCM kind of customer base, stick to your customer then the legacy GAIN or sitting next to other customers that for which you've bought or organically grown previously?

Glenn Stevens
Okay. So the FXCM customer set looks a lot like what we've seen by ourselves, if you will, in that there is a generally small cadre called a 10% to 15% that will come across as more highly valuable and so there is definitely some of those rules, if you will, or paradigms that we've seen other brokers have in GAIN as well. And so that those are the customers we focused on to make sure that assets are activated and such.

We also think that if you think about, you kind of look at the total aspect and say well, how much of client equity came over when you retained 81% of its own terms of retention efforts for FXCM's assets where they got a little higher retention and follow up and focus to make sure they settled in right. That was effective, we were happy about that, but in terms of their profile being different, no. That said, the other way to work on the retention that I think what we are seeing similar to the broader universe of discount brokers, is that even when activity wanes after some period of time, call it 8 months to a year and a half. You see a pretty regular situation where customers will ebb and flow being more active or less active, based on lots of factors, some of them personal to the clients, some of them being broad to the market. But, it's on us now to develop some additional products and offering some services that gets a higher MPV in that trail of value.

So, even if the rate of revenue from that client ebbs, then their total lifetime value actually goes up. And that's okay because their payback period now if you will from what it cost to the client in we actually not change, but the LTV or lifetime value will go up. But, only if we can service the clients with things like more advisory with longer term focused products whether that means, you know, equity-related-type things or options or what have you. We have to expand our suite of products globally to make sure the client has other options within GAIN or this is just the higher concentration of the actively traded products like the currencies and products we have now.

So, that's our goal is to lengthen our relationship with them so that their value goes up, to make the process of bringing them even worthwhile.

Dan Fannon
Okay. And then, you obviously have talked about the LCM of the rate familiar and for us to think of it on a longer-term basis. But, I guess if you could just give us a sense of how, you know, kind of July trended or the third quarter is often sort of is there any material change to what you saw in the second quarter?

Glenn Stevens
No, that's really the takeaway is correct. I may I reiterate the fact that there is nothing unique about the variability that we have seen Q4, Q1, Q2 so I am going from Q4 of 2016 and then last two quarters. There is nothing unique about that variability or change to our customer mix or our risk profile or trading operations anything to suggest that we still don't expect a convergence or regression to that mean that we keep harping on to say start with 100 bucks and kind of go from there. There is some indication if you will in Q3 that…that there is a consistency of what I am saying there. In other words following along, again not giving us any indication that the gyrations wouldn't be necessarily be now or over time versus why or over time.

Don Fannon
Got it. Thank you.

Glenn Stevens
Sure.

Operator
Thank you. And once again if you have a question please press "*" and then "1".

And the next question comes from Patrick O'Shaughnessy of Raymond James.

Patrick O'Shaughnessy
Hi, good afternoon. So, for the first question, of the $15 million in fixed cost savings that you are targeting for 2017, what's the run rate that you exited the second quarter at?

Nigel Rose
So, as I mentioned on one of the earlier questions, if you normalize out some of that noise and then the one-off and the timings, the fixed costs in the second quarter were nearer 48 million. That said, within there, there is a component that wasn't out of the target of the 15 to 20 million cost savings, which was staff cost. So if you strip those out then arguably the underlying run rate is around 22.5 million and that will compare to 23.5 million in Q1.

Patrick O'Shaughnessy
Got you. So, kind of annualized you're $4 million into your $15 million target?

Nigel Rose
With the…on a similar basis we exited Q4 I would say we are…we are probably in that range, four to five in with the rest [indiscernible] during the rest of the year.

Patrick O'Shaughnessy
Alright. Got it. That's helpful. Thank you. And then, as long as we are talking about expenses, referral fees were relatively low and I know that, you have been making some changes to kind of keep those under control. But, down pretty nicely quarter-over-quarter, particularly in your retail group despite some higher volumes and despite that improved [indiscernible]. So, can you speak a little bit to what we are seeing going on with some of the referral fees?

Nigel Rose
Yes, I mean, the referral fees in total are down in retail because of that I mentioned earlier, the mix of the indirect volume and how that's fallen from 40% of total volumes to 30% in Q1 sorry Q2 17. So, that will.....the indirect volume itself has come down and therefore reduced referral

fees. We continue to focus around the optimization of what we pay for that business in terms of the referral fee per million, which was, I think, it ticked down a little bit Q2 over Q1. And then again similarly in the futures business what we have seen there with those low levels of volatility and the impact on volumes in futures is again similarly that referral fees in that business have declined as well. But, that's largely driven more by volume whereas in retail it's a mix of volume and unique cost.

Patrick O'Shaughnessy
I got it, okay. Speaking of the futures segment, obviously I think somewhat depressed volumes to start the year, Ag trading hasn't been particularly strong in exchanges, is there, the EBITDA margin I think is probably around 4% to 5% year-to-date for that segment. Is there a plan to get that higher even in a depressed revenue environment or is it thought that eventually volatility is going to come back to Ags and the revenue growth is going to be what takes the EBITDA margin up there?

Glenn Stevens
That's right Patrick. I think that not to rely on the crop of low vol, but when it comes to futures, unlike the CME, where they will still get the benefit of volumes going through to hedge interest rates and books and things like that.

Our customers need a reason to trade. And so in this respect whether they are Ag hedgers or opportunists looking for market trades in any of those products when that vol goes to 20 year lows it's hard to pop out. That said, if you look at our futures business probably over a year ago this would have been not marginally profitable at all. And so, two things, one, we have made some progress on being able to generate more EBITDA from customer assets. And so that's good news in that at least we timed it with some material interest rates whereas we probably weren't doing a good job at it at all.

The good news is interest rates are zero anyway, so it didn't cost us anything not to be good at. So, that's helpful. I think we still have some improvement there and we are starting to…pretty much quarter over quarter even without interests rates changing we are doing a better job on the treasury side if you will.

On the other part to agree with you, yes. Any kind of an uptick in volumes or val will translate directly and we like that EBITDA margin as we have seen in the past there north of 10%, more like 12 to 15 than the kind of 5 to 6. So we consider 5 to 6 anemic and it's not what we modeled in that we what we are going for, you look at the full year or first half if you will, 2016 it was 11%. We kind of looked at 11% saying that needs to be at last at 15. I don't know if that's really going to be a 25 to 30% business any time soon, because it doesn't seem like scale or that you grow out of it, there's things we can do to improve it, but look there are some other capital efficiencies and such that that even in that 15% range it makes sense. It's got a very high variable cost structure right now.

Patrick O Shaughnessy
Got it. And then, one more from me. If I could…on the institutional space certainly you have a lot of stuff going on competitively obviously it's the new owner of Fastmatch, as we discussed earlier, that has certainly incentivized to try to grow some market share there. So, what are you seeing on the competitive landscape right now for the…that you see in?

Glenn Stevens

So, you know, looking at a couple of the reported numbers on volumes with Fastmatch, we stack up modestly favorable if you look at over. If you look at July over June and June over May for Fastmatch for example we compare favorably in terms of our volumes month over month. We have grown a little bit there; they are losing a little bit. So, again I am not shouting from the rooftops, but at least recent traction has been kind of okay, we are frankly hopeful that anytime a company gets bought, there is a tendency to lose sight of the day-to-day a little bit or lose some of your nimbless and so maybe we could take some advantage there. So, strictly in a comparison basis I think that our ECN unit is operating pretty well, and in terms of…internally for ourselves as an earlier call question said, we do think there are some opportunities potentially to monetize that and we have added recently things like getting our [indiscernible] fully approved to be able to be operational that we would be able to take advantage as well. So, I take on several fronts it's a positive story.

Patrick O'Shaughnessy
Great, thank you.

Glenn Stevens
Thanks Patrick.

Operator
Thank you. And the next question comes from Alan Webber with Robotti.

Alan Webber
Hi, I might have missed this because I had to get off for a second. But, can you talk about as you looked out when you talk about kind of targeting the EBITDA margin, kind of what is that, do you need acquisitions, what you need to really actually get to that level of EBITDA margin?

Glenn Stevens
We have never actually relied on strategic M&A to drive things only because even though one could argue with a dozen transactions over the last decade you could kind of count on us to do a deal pretty regularly. I think that we did not factor that it. That we would consider that in the gravy department. We are models to driving a higher EBITDA would be the combination of our organic growth initiatives and cost control. If a strategic opportunity is there for us, we will evaluate that on its merits and how it fits in with our strategy, but that's not part of, if you looked at our financial model today and say how are we going to get that walk to the 35% EBITDA margin, it doesn't say here's two or three strategic M&A situations that we don't know are there yet. We wait for them to happen. That's it.
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Alan Webber
I guess the other question is what kind of general market conditions do you think you need to reach that?

Glenn Stevens
Well, again, that I think that if you go back to our trailing 12 or two year, you use that kind of 100 plus RPM if that's a representation of a market condition that would be more than sufficient.

Alan Webber
Okay, great. Thank you very much.

Glenn Stevens
You are welcome.

CONCLUSION

Operator
Thank you. And I am showing no further question at this time. Ladies and gentlemen that conclude today's call. As a reminder, this call will be available for replay via telephone and on the Gain Capital IR website. We do thank everyone for your participation. You may now disconnect.