

## Nothing ventured, nothing GAINed?

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By Minda Westhoff

Although bolstered by attractive revenue growth and notable underwriters, it remains unclear to what extent the market will welcome GAIN Capital Holdings Inc.'s recently filed IPO, with industry observers citing concerns about valuation levels and the company's reported use of proceeds.

As detailed in the company's registration statement for the offering, GAIN Capital is an online provider of retail foreign exchange trading. Founded in 1999, the company operates Web site FOREX.com, which offers online trading services to customers in more than 140 countries.

Having established operations in place will help the company, said University of Florida finance professor Jay Ritter, as the IPO market since 2000 has given a "cold shoulder" to small and startup companies. Also, valuations across the board are more attractive now than in the first quarter, when the market was bottoming out.

"It's still the case that valuations are modest, but there's not the extreme situation of six months ago where the cost of raising external capital for anything but completely safe securities was extremely high and very likely to be coming down," Ritter said.

Though employing slightly different business models than that of GAIN Capital, a number of online brokerage companies have seen their shares perform relatively well year-to-date, after a rough 2008. Charles Schwab Corp. and E\*TRADE Financial Corp. have seen their shares rise 10.70% and 31.13%, respectively, so far this year, and TD Ameritrade Holding Corp. and optionsXpress Holdings Inc. have seen increases of 33.68% and 27.40%, respectively.

However, Ritter noted a number of potential challenges for trading venues, including the rapid evolution of technology, the competitive environment and regulatory restraints.

While GAIN Capital has experienced notable revenue growth between the first and second quarters, IPO Financial Network President David Menlow said it is a buyer's market, a reality the company will be faced with when it comes time to price. Though much improved, Menlow said valuations are still heavily weighted in favor of buyers of shares, not the issuers.

"I would say it is not a good time for any company to come public because of that imbalance," Menlow said. "But that's if you're speaking on behalf of the issuer. For the investors, it's a wonderful, wonderful time."

Although IPOs may be unattractive from a pricing standpoint for any company, IPOBoutique.com senior managing partner Scott Sweet expressed particular concern about GAIN Capital's offering given the termination of its Chinese operations in late 2008.

Sweet pointed to a section in the company's IPO filing detailing that the China Banking and Regulatory Commission in May 2008 found the company to be out of compliance with regulations that required a permit to provide retail foreign exchange services to Chinese residents over the Internet, a permit that GAIN Capital never acquired during the 2003 to 2008 period it operated in the country.

"Ironically, the company said in the filing it did not know such a permit was needed to exist, which is kind of bogus," Sweet said.

The fact that all proceeds will go to GAIN Capital's existing shareholders is also a "huge red flag" for Sweet, as many companies that have recently completed IPOs have instead put proceeds toward building the business or paying down debt.

Due to the current status of GAIN Capital's pending IPO, company spokeswoman Alicia Brown was not able to comment.

While such a use of proceeds is always an area of concern, according to IPO Desktop President Francis Gaskins, it is worth mentioning that the company's business model does not require large amounts of money to operate. Since most of GAIN Capital's shareholders are venture capital groups, they likely need the money for other investments, and the company's quarter-over-quarter revenue growth puts it in a comfortable position without the proceeds.

The lining up of two bulge-bracket firms as underwriters, Morgan Stanley & Co. and Deutsche Bank Securities Inc., may also help GAIN Capital's chances. The two investment banks having signed on came as a surprise to Sweet, and Menlow said getting those two stamps of approval will likely be pivotal in completing the deal, especially if investors determine that the company's fundamentals, including margins, market penetration and growth expectations, are sound.

"These are all the items that investors are going to zero in on after they feel somewhat of a warm and fuzzy feeling that Morgan Stanley and Deutsche Bank are on this offering," Menlow said.

For Gaskins, it all hangs on the company's third quarter. If GAIN Capital's quarter-over-quarter revenue growth continues, the company will stand a good chance of going public, but if it stumbles in the September quarter, the process may slow if not stop.

Menlow said a successful IPO could be an impetus for other companies to move forward with their offerings. But Menlow said the bulk of the market share will likely go to whatever company in the broker/dealer arena files first.

"It would be a shame if some of these other companies sat around and said, 'We're going to put our nose to the grindstone,' and in the meantime, all the coverage in the media is focused on GAIN Capital," Menlow said. *i*