Knight Capital jumps on Getco buyout offer

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Four months after a major software malfunction at Knight Capital Group roiled markets and threatened the company's survival, a rival trading firm stepped in with an offer to buy Knight at a steep premium.

Getco put up a cash-and-stock offer that values Knight shares at $3.50—a 41 percent premium over the closing price on Nov. 23, before the first published reports about a possible buyout. But it's a fraction of the company's worth before the meltdown.

Knight shares soared 14 percent in mid-day trading and the company postponed an investor conference scheduled for Monday.

The company has one of the most advanced platforms for trading brokerages. The Jersey City, New Jersey, company takes stock trading orders brokers like TD Ameritrade and E-Trade. It routes the orders to exchanges including the New York Stock Exchange.

Getco's offer provides a possible path forward after Knight suffered massive losses from the malfunction that sent the shares of dozens of publicly traded companies haywire, blasting out nonsensical orders that few could, or would, match.

Getco offered Knight shareholders "a significant cash payment" as well as a chance to profit from the company's rebirth as part of a new entity.

The merger would involve a two-step process, according to a letter from Getco to Knight, beginning with the issuance by Knight of 242 million new shares and warrants to Getco investors. The warrants would allow holders to buy Knight stock at a set value on some future date.

The combined company then would offer to buy up to $539 million worth of Knight shares at $3.50 apiece. The offer would cover half of the outstanding Knight shares not already owned by Getco. The former owners, including Getco, would not be eligible to sell their stock. They would end up with a controlling stake in the company.

Getco already owns 57 million shares of Knight—about 31 percent of all outstanding shares.

Under the deal, Getco could end up paying more than $1 billion for Knight. That's the value of Knight's outstanding shares less the value of Getco's existing stake in Knight. The actual value of Getco's offer, however, would vary based on how many investors choose to sell their shares in the second phase of the merger.

A Getco spokeswoman declined to elaborate on the letter, which was filed Wednesday with the Securities and Exchange Commission.

Getco became a major stakeholder after pitching in on a $400 million bailout of Knight this summer along with Jefferies Group, Blackstone, Stephens, Stifel Nicolaus and TD Ameritrade.

Those companies own stock that could be converted into a 73 percent stake in Knight—enough to effectively control the company after it was a hobbled by $461.1 million in losses directly related to the technical breakdown.

On Aug. 1, dozens of stocks rose and fell sharply for no apparent reason after Knight flooded the New York Stock Exchange with erroneous orders. Shares of company then called Wizzard Software, for example, raced 300 percent higher for no apparent reason.

After the problem was traced back to Knight, its shares lost three-fourths of their value in two days, forcing it to cede control of its operations on the New York Stock Exchange and seek a lifeline.

The timing of the malfunction, which would have been devastating at any time, was magnified by a series of market irregularities that raised questions of fairness and stability on U.S. stock exchanges given today's technology.

A flash crash in 2010 that sent the Dow Jones industrial average down 600 points in five minutes was followed this year by bizarre market entries by Facebook and BATS Global Markets, an exchange operator.

Getco said Wednesday that it has secured $950 million to help finance the deal.

Getco CEO Daniel Coleman would become CEO of the combined company and join its board of directors, according to a letter it sent to Knight Capital and its CEO, Tom Joyce. Joyce would become non-executive chairman.

The offer, the first to be aired publically, comes less than a week after The Wall Street Journal reported that two rivals had already approached Knight about buying its market-making operation, which matches buy and sell orders for stocks and other investments. The Journal reported Tuesday that Virtu Financial LLC, another high-speed trading firm, was preparing an all-cash offer.

Getco Holding Co. LLC, based in Chicago, is owned mainly by its partners and executive team. Its only outside investor is General Atlantic, a private equity firm based in Greenwich, Connecticut. General Atlantic bought a minority equity interest in Getco in 2007.

Knight shares rose 43 cents to $3.40 in afternoon trading It traded around $13.50 earlier this year, but scraped bottom at $2.24 after the August disruption.