Interactive Brokers Group's (IBKR) Q3 2014 Results - Earnings Call Transcript

Interactive Brokers Group, Inc. (NASDAQ:IBKR)
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Executives
Thomas Peterffy - Chairman and CEO
Paul Brody - Group CFO
Deborah Belevan - Director, IR

Analysts
Rich Repetto - Sandler O'Neill
Niamh Alexander - Keefe, Bruyette & Woods
Mac Sykes – Gabelli & Company
Sean Brown - Teton Capital
Andrew Bond - Wells Fargo
Rob Koehn - Ivy Lane Capital

Operator

Good day, everyone, and welcome to the Interactive Brokers Third Quarter 2014 Earnings Results Conference Call. This call is being recorded.

At this time for opening remarks and introduction, I would like to turn the call over to Ms. Deborah Belevan, Director of Investor Relations. Please go ahead.

Deborah Belevan - Director, IR

Thanks, operator, and welcome, everyone. Hopefully by now you've seen our third second quarter earnings release, which was just released today after the market closed, and is also available on our website. Today, our speakers are Thomas Peterffy, our Chairman and CEO; and Paul Brody, our Group CFO. They're going to start the call with some prepared remarks about the quarter and then we'll take some Q&A.

Our call may include forward-looking statements which represent the Company's belief regarding future events and by their nature are not certain and outside the Company's control. Our actual results and financial condition may differ possibly materially from what's indicated in these forward-looking statements. We ask that you refer to the disclaimers in our press release. You should also review a description of the risk factors contained in our financial reports filed with the SEC.

I'd now like to turn the call over to Thomas Peterffy.

Thomas Peterffy - Chairman and CEO

Thank you for joining us to review our third quarter performance.

This quarter we set new records in our brokerage business with total number of accounts, customer equity, margin balances, profits and profit margins reaching all-time highs. The message that IB is the best platform to minimize trading costs and optimize execution quality is spreading amongst professional traders and investors around the world. Our brand recognition is strengthening not only in the U.S. but in markets throughout Europe and Asia, where we are still way behind in terms of market penetration and where our primary advantage of being the lowest cost broker, is even more pronounced. In international markets our competitors are priced even higher by comparison, and word of mouth advertising is very effective. All this bodes very well for our prospects of continuing strong account growth.

Unfortunately, this stellar performance was overshadowed by unusually strong currency movements, namely the strengthening of the US dollar, which negatively impacted our reported results in market making. As you know by now, we maintain our equity in a basket of 16 currencies that we call the GLOBAL in order to stabilize the currency risk we would otherwise be exposed to as a global company doing business in various currencies around the world. However, when we translate our results into US dollars for reporting purposes, the relationship between the US dollar and the GLOBAL is reflected in our financial statements.

Usually the fluctuations are less than 2% from quarter to quarter. However, this quarter the dollar strengthened considerably against all other major currencies globally, which created an unusually large currency translation loss for us. This quarter, the GLOBAL fell by about 4% compared to the US dollar, which reduced our comprehensive earnings by $211 million. Of this total loss, $133 million reduced our trading gains and $78 million is reflected in Other Comprehensive Income, or OCI.

If we back out the currency effects from our results, the picture is much clearer.

For the quarter we reported pretax income of $40 million. Backing out the currency effects, this was $172 million comprised of $152 million in Brokerage and $21 million in Market Making and a loss of $1 million in Corporate. As you can see, brokerage continues to be the dominant segment, accounting for 88% of currency adjusted pretax income this quarter.

Customers are coming to our platform. A key differentiator that is driving this trend is our significant cost advantages over other brokers. Not only do we offer much lower commissions, our customers achieve the industry's best price execution thanks to our superior order routing technology and firm commitment to not engage in the practice of selling our customer order flow like most other Brokers do.

In August, I submitted a letter to the SEC recommending that they require all brokers to publish cost of execution metrics that would once and for all, allow investors to compare trading costs across brokers. This letter is published on our site under About IB and Comment Letters and Papers. While the SEC is currently evaluating payment for order flow and market structure issues that may favor high frequency traders over retail investors, it remains to be seen how the regulator will proceed. Their repeated call for transparency speaks in our favor.

Hopefully by now you've seen the Reg NMS execution data we've started including with our electronic brokerage metrics that we publish monthly. The bottom line is our customers have paid merely 1 basis point [or one hundredth of one percent] year to date in total trade costs as a percent of total trade value. Total trade cost is comprised of commissions, fees and market impact. The way we calculate this number is that we compare total, all-in trading cost with executing at the daily Volume Weighted Average Price, or VWAP, without any additional cost.

A key observation when viewing these statistics is that in certain months, and for the entire 9 months year to date, our customers' execution cost or market impact is actually a negative amount. This is due to our SmartRouting technology, that automatically routes each customer order to the venue that will at any moment probabilistically produce the lowest net trade cost for the customer by taking into account accumulated, rolling statistics on potentially better prices and rebates or fees. One basis point of total trade expense is a remarkable result, especially if you consider the fact that from this we must pay SEC fees of 0.2 basis points on sales.

We are nowhere near finished with building this system. We keep refining it and updating it as new transaction venues and new rules appear all the time. While our competitors are trying to figure out how to maximize their income from selling their customers' orders to others, who in turn, are trying to maximizing their income that they derive from taking the opposite side of those orders, we dedicate our software development resources to secure the best price for our customers. These are two entirely opposite business models. How can they both be right? We believe that the better the prices we get for our customers, the better their performance will be and the more business they will bring to us. On the other hand, our competitors believe that most customers can't tell the difference between good and bad executions. I think we both could be right. As a result, they end up with the customers who can't tell the difference and we end up with those who can.

I like the side we are on and so do more and more traders and investors around the world.

Now, I'll review the third quarter highlights for brokerage.

In spite of the usually subdued summer activity levels, we were helped by 18% growth in the number of customers by the end of this quarter over the same period last year and, as a result, our total DARTs were 13% higher YoY. By comparison, average daily volume on U.S. exchanges for equities fell 4% and options increased 8% during the same period. Our growth rate in DARTs also exceeds those of our larger peers. It continues to be the case that our customers are far more active, and for that reason we continue to be the largest U.S. electronic broker as measured by total number of revenue trades, which averaged 534 thousand per day in the third quarter, despite having significantly fewer accounts than the large eBrokers and we expect our lead to widen further in the future.

The annual increase of 18% resulted in 272 thousand customer accounts at September 30, and this growth rate is picking up steam. Last year at this time, our annual growth rate was 13%.

Year to date, customer account growth has averaged 3,700 accounts per month compared to 2,400 accounts per month in 2013. This growing momentum is a testament to the proliferation of positive feedback from our current customers which attracts referrals, our leading source of new accounts, and the solid reputation we have earned.

Customer equity has reached $54.9 billion, 33% higher than a year ago. While the rise in market values as of Sept 30 contributed somewhat, as demonstrated by the 17% YoY increase in the S&P, most of this growth comes from new accounts and current customers bringing more assets to our platform. The average equity per account has also risen 13% year over year to 202 thousand dollars.

We also delivered a record pretax profit margin of 63% this quarter thanks to our highly automated and scalable business model which allows us achieve industry leading profit margins while also still being the lowest cost broker.

Margin balances have grown to a record $17.3 billion, a 36% increase over the prior year. Customers are attracted to our industry low financing rates which range from 0.5 percent to 1.58 percent.

We continue to focus on enhancing our trading technology and developing new trading tools to maximize the value of our platform, while keeping our trading and financing costs significantly lower than our competitors. This quarter we announced a number of new features we've added to our advanced trading and risk management tools, including enhancements to the Risk Navigator, Charts and Mosaic Market Scanner and two important new features for option traders.

People who would like to run an option overlay strategy are often reluctant to do so because if the option is assigned they may have to give up a stock in which they have a gain that they do not wish to realize for tax purposes. At times like that it is ordinarily too late to buy new stock to deliver because that settles in three days and the assignment settles in two days. To get around this problem we are now enabling our customers in these circumstances to buy stock for two day settlement to deliver against the assignment and hold on to their unrealized gains.

Another issue for option traders is that they often leave money on the table when they do not exercise sufficiently in-the-money options before ex dividend dates. We are now using our option valuation models to calculate if an option is worth more when exercised. In such cases we notify our customers and also give them the ability to provide us with a standing instruction to exercise for them in such situations in the future.

I should also mention that our clients can now optimize their routing preferences for non-marketable option orders to find the sweet spot between maximizing the probability of execution and minimizing the venue fees. To illustrate, they can select amongst several options including maximizing the rebate, or preferring a fill versus a rebate or vice versa and balancing between getting a rebate and filling the order.

This quarter we expanded our Risk Navigator as requested by some hedge fund customers who want to analyze their positions in terms of individual stock beta, rather than straight percentages.

And finally, we added on-demand Transaction Cost Analysis. Our customers can now, at any time during the day examine their executions against various benchmarks, either singly or in any grouping of their choice.

Now I'll review the performance in our market making segment.

As I mentioned, market making was hit this quarter with an unusually large currency translation loss. The portion of the loss that impacted the P&L was $133 million, which reduced trading gains.

If we back this out, pretax profits in market making, ex translation, would have been $21 million this quarter. This compares to $41 million in pretax profits ex translation for the year ago quarter and $31 million in the previous quarter.

This decline can be attributed to, among other things, the ongoing, difficult competitive environment, low volatility levels, a large error to the tune of about 16 million dollars in the course of the quarter, that in retrospect we did not handle well and increased M&A activity, all of which negatively impacted out market making results. The VIX averaged 13 in the third quarter, compared to 14 in the year ago quarter.

The ratio of actual to implied volatility was actually higher, rising from 63% in the year ago quarter to 72% in the current quarter and 73% in the previous quarter.

Exchange traded option volumes increased 5% in the U.S. and increased 13% globally from the second quarter. By comparison, our firm's total option volume increased 5%. As a result, our firm's market share decreased from 11.4% to 10.9% in the U.S. and from 8.7% to 8.1% globally.

In the Market Making segment alone our option volume increased by 4% during the third quarter, which drove our market share in that segment from 5.1% to 4.5% in the U.S. and from 4.7% to 4.3% globally. Our market share in this segment has slowly been declining as we reduce our participation in less profitable markets.

We are executing on our vision: to create a global marketplace for different type of customers and service providers to meet, link up and enter into relationships to do business with each other on our platform. For example, individuals can shop for financial advisors, Wealth Advisors can peruse a list of Money Managers, hedge funds can select administrators and accountants, and investors can evaluate and invest directly in hedge funds on our platform. We believe that facilitating these relationships will attract more new customers and expand business amongst our current customers who will hopefully remain on our platform.

We think that people who get far enough on our platform to explore our new marketplace, really believe that we do everything we can to maximize their returns and we do. It is a consequence of our relentless focus on ways to maximize our customers' returns that keeps us ahead of our competition.

Finally, having reached the age of 70 I think it is prudent to have a public succession plan for the business. Accordingly, this morning Milan Galik was appointed as president of IBG LLC, our holding company and Interactive Brokers Group Inc., the public company. Milan graduated from the Technical University of Budapest in electrical engineering 24 years ago and became a software developer at our firm in the same year. He is currently in charge of development of trading systems, market data delivery and order routing systems, both for our market making and brokerage businesses. For several years he has been an important member of our steering committee, chairing meetings in my absence and he is familiar with most aspects of our business. We are fortunate and proud to have him in his added role. We expect that practical changes in the management of our business will be very gradual and occur over a long period of time.

And now, Paul Brody will go over the financials.

Paul Brody - Group CFO

Thank you, Thomas. And welcome everyone, thanks for joining the call. So as usual, I'll review our summary results and then give segment highlights before we take questions.

Results for the third quarter were driven by two stories: outstanding results in brokerage and tepid profits in Market Making, both of which were overshadowed in headline numbers by large currency translation losses on the strength of the U.S. dollar. Brokerage fees also benefited from higher commission revenue and especially net interest income. Market Making results were further impaired by the trading error that Thomas mentioned.

Our financial statements include the GAAP accounting presentation known as comprehensive income. Comprehensive income reports all currency translation gains and losses, including those that reflect changes in the U.S. dollar value of the Company's non-U.S. subsidiaries, known as other comprehensive income or OCI. These are reported in the statement of comprehensive income. The U.S. dollar strengthened relative to all other major currencies during in the third quarter of 2014. As a result, the currency basket in which we keep our equity, which we call the GLOBAL, weakened against the U.S. dollar by an unusually large 4%. OCI is a component of the total GLOBAL effect and the rest is contained in trading gains. We estimate the total negative effect from the GLOBAL on our reported EPS for the quarter to be about $0.38 with $0.18 reported as OCI and $0.20 as trading loss.

Overall, operating metrics for the latest quarter were generally up across all major product types versus the year ago quarter. Average overall daily trade volume was 1.13 million trades per day, up 14% from the third quarter of 2013.

Electronic Brokerage metrics continue to show solid increases in the number of customer accounts and customer equity. Total and cleared customer DARTs were up 13% and 14% respectively from the year ago quarter and up marginally from the prior quarter. Orders from cleared customers who clear and carry their positions in cash with us and therefore contribute more revenue accounted for 91% of total DARTs, holding steady with recent quarters. Market Making trade volume was up from the prior year quarter, though contract and share volumes were down. Other metrics were also mixed as volatility levels were down, but the actual to implied volatility ratio was up this quarter.

Net revenues were $171 million for the third quarter, down 48% from the year ago quarter. Trading gains netted to a loss of 76 million for the quarter driven largely by currency translation effects. Excluding the currency translation, trading gains would have fallen by 26% from the year ago results.

Commissions and execution fees were $133 million, up 10%. Net interest income was $98 million, up 59% from the third quarter of 2013. Brokerage produced $93 million and Market Making 6 million. And other income was $16 million, down 24%. Non-interest expenses were $132 million, up 1% from the year ago quarter. Within the non-interest expense category, execution and clearing expenses totaled $52 million, down 7% from the year ago quarter, driven by lower volumes in Market Making.

Compensation expenses were $49 million, a 12% increase from the year ago quarter. At September 30th, our total headcount was 937, an increase of 7% from the year ago quarter and the prior year-end. Within the operating segments, we continued to add staff in Brokerage and cut back in Market Making. As a percentage of net revenues, total non-interest expenses rose 77% from 40% in the year ago quarter. Out of this number, execution and clearing expense accounted for 31% and compensation expense accounted for 29%. Our fixed expenses were 46% of net revenues. Of course, all of these measures were inflated by the negative currency translation impact on net revenues.

Pre-tax income was $40 million, down 80% from the same quarter last year. And for the quarter, ex-currency effects, Brokerage accounted for 88% and Market Making accounted for 12% of the combined pre-tax income. For the third quarter, our overall pre-tax profit margin was 23% as compared to 60% in the third quarter of 2013. Brokerage pre-tax profit margin was 63%, up from 56% in the year ago quarter and Market Making turned in a pre-tax loss. But excluding translation effects, Market Making pre-tax profit margin was 34% in the latest quarter.

Comprehensive diluted earnings per share were a loss of $0.13 for the quarter as compared to earnings of $0.39 for the third quarter of 2013. On a non-comprehensive basis, which excludes OCI, diluted earnings per share on net income were $0.05 for the quarter as compared to $0.32 for the same period in 2013.

Turning to the balance sheet, as a result of the growth of our Brokerage business and the withdrawal of capital from our Market Making operations through regular and special dividends, Brokerage now accounts for about 75% of our combined balance sheet assets from the two segments. From the year ago quarter, cash and securities segregated for customers rose 17% and secured margin lending to customers rose 36%, while positions in securities held by our Market Maker units were paired back by 23%.

According to our announced policy, regular quarterly dividends will continue to temper the capital employed in the Market Making segment. In the third quarter, our Market Marking earnings fell short of the amount needed to fund the dividend. Our balance sheet remains highly liquid with low leverage. We actively manage our excess liquidity and we maintain significant borrowing facilities through the security lending markets and with banks. As a general practice, we hold an amount of cash on hand that provides us with a buffer should we need immediately available funds for any reason. At September 30th, we maintained our $3 billion in excess regulatory capital in our broker dealer companies around the world, of which about 68% is in the Brokerage segment. We continue to carry no long-term debt. And our consolidated equity capital at September 30, 2014 was 5.9 billion, of which approximately 2.9 billion was held in Brokerage, 2.1 billion in Market Marking and the remainder in the corporate segment.

Turning to the segment results, we'll start with Brokerage. Customer trade volumes were up across all product types. Cleared customer contract and share volume was up 33% in options, 2% in futures, and 69% in stocks. Much of the stock volume increase came from trading in low priced stocks. Foreign exchange volume also declined from the year ago quarter.

Customer accounts grew by 18% over the total at September 30, 2013, and by 4% in the latest quartet. Total customer DARTs were 534,000, up 13% from the year ago quarter and 1% from the second quarter of 2014. Our cleared customer DARTs were 485,000, up 14% on the year ago quarter and up marginally from the prior quarter. The average number of DARTs per account on an annualized basis was 455, down 3% from the 2013 period and 4% sequentially.

Commission revenue rose on a product mix that featured larger average trade sizes in all product types. This resulted in an overall average cleared commission per DART of $4.21 for the quarter, lower by 3% from the year ago quarter, but up 5% sequentially. The large volume executed in low price stocks on which our commission is capped can skew these numbers somewhat. Also note that commissions include exchange fees which can vary widely.

Customer equity grew to $54.9 billion, up 33% from September 30, 2013, and up 2% sequentially, well outpacing the S&P 500 Index, which rose 17% over the past year and 0.6% over the last quarter. The source of this growth continues to be a steady inflow of new accounts and customer assets. Margin debits continue to build steadily, increasing the 36% over the year ago quarter. Customer credit balances also continued to growth progressively, increasing 21% over the year ago quarter, though spread compression persists in restraining net interest income.

Higher trade volumes resulted in top line revenue from commissions and execution fees of $133 million, an increase of 10% from the year ago quarter and 7% sequentially. These revenues are spread mainly across options, futures, stocks and foreign exchange. Net interest income rose to $93 million, up 66% from the third quarter of 2013 and 21% sequentially. Low benchmark interest rates, which continue to compress the spreads earned by our Brokerage unit, have been offset by steadily higher customer credit balances in each successive period. And our aggressive lending rates continue to boost customer margin borrowing.

Our fully paid Stock Yield Enhancement Program continues to provide an additional source of interest revenue that is shared with our participating customers. And we continue to improve our securities lending utilization to capture more revenue from lending hard-to-borrow stocks. Net interest income as a percentage of net revenues rose to 38% as our Brokerage revenues are increasing diversified between commissions and net interest income.

With a growing customer asset base, we believe we're well positioned to benefit from a rise in interest rates. Based on current balances, we estimate that a general rise in overnight interest rates of 25 basis points would produce an additional $55 million in net interest income annually. Further increases in rates would produce smaller gains because the interest we pay to customers is pegged to benchmark rates less than narrow spread.

Execution and clearing fees expenses increased to $37 million for the quarter, up 2% from the year ago quarter and 7% sequentially, reflecting higher trading volumes. Fixed expenses increased to $53 million, up 7% on the year ago quarter. And pretax income from Electronic Brokerage was $152 million for the third quarter, up 41% on the year ago quarter and 16% sequentially.

Turning to Market Making. The Market Making trade volume in terms of number of trades was up 15% from the prior year quarter, though contract and share volumes were down 13% in options, 17% in futures and 1% stocks. Trading gains from Market Marking for the third quarter of 2014 netted to a loss of $76 million as compared to a gain of 123 million in the year ago quarter. Currency translation had a large negative impact, reversing the third quarter's reported earnings by $133 million, a substantial swing from the year ago quarter when reported earnings were increased by $46 million.

Pretax loss from Market Making was 112 million for the quarter as compared to a gain of $88 million in the year ago quarter. Eliminating the currency effect from each period, the year-over-year change in pretax income from Market Making would be a decrease of 49%. Our overall equity as measured in U.S. dollars was decreased by the strengthening of the U.S. dollar against all other major currencies. More specifically, we measure the overall loss from our strategy of carrying our equity in proportion to the basket of currencies we call the GLOBAL to be about $211 million for the quarter. Because a $78 million translation loss is reported as other comprehensive income, this leads to a loss of 133 million to be included in reported earnings. To summarize this, if we eliminated all currency effects, pretax income from Market Making for the third quarter of 2014 would be about $21 million versus 41 million for the year ago quarter on the same basis.

Execution and clearing fees expenses fell to $15 million for the quarter, down 24% on the year ago quarter driven by lower trading volumes, primarily in options. And fixed expenses were $27 million, up 11% from the year ago quarter primarily due to employee compensation which reverted to a more normal run rate in comparison to the year ago quarter in which certain adjustments are recognized. We continue our aggressive expense management as we monitor the performance of the Market Making business.

Now I'll turn the call back to the moderator and we'll take some questions.

Question-and-Answer Session

Operator

Thank you. (Operator Instructions) Our first question comes from the line of Rich Repetto from Sandler O'Neill. Your line is open.

Rich Repetto - Sandler O'Neill

I guess the first question, Thomas, could you just give us a little bit more details on the $16 million trading loss, because that certainly weighed on the results for this quarter, the Market Making results.

Thomas Peterffy - Chairman and CEO

Well, it was in an area of our software that is used from time-to-time and it's kind of technical to really go into it in much detail. At this time the situation that it was applied to had a strange twist in it and the software misunderstood the situation and did their own thing.

Rich Repetto - Sandler O'Neill

So, could something like this -- is this like – it could ever happen again or do you think it's prevented now?

Thomas Peterffy - Chairman and CEO

Well, this same thing will not happen again. But software, from time-to-time, errors can always happen in a software, as you know. Apple comes out with a -- or anybody comes out with a new chip, sooner or later you find the bug in the chip.

Rich Repetto - Sandler O'Neill

And then I know the market conditions -- you went through the metrics, can you just give us a little feel, like the world has changed at least in October today. Can you give us a little color on the market conditions in 4Q in October that you've ran into so far?

Thomas Peterffy - Chairman and CEO

You see what I see.

Rich Repetto - Sandler O'Neill

So it would be very, very strong, vast contrast to 3Q?

Thomas Peterffy - Chairman and CEO

Well, volumes are at much higher as we all see, right?

Rich Repetto - Sandler O'Neill

Right. And actual to implied is almost right around 1% or up in the 0.9%?

Thomas Peterffy - Chairman and CEO

You mean as far as Market Making. I think we don't really – we're not doing very well in Market Making.

Rich Repetto - Sandler O'Neill

Okay. I guess the last, well, let me follow on that then. Even with the metrics that we normally follow like the actual to implied, the volumes and the VIX, all showing significant improvement in October. You're saying it's not significantly better so far?

Thomas Peterffy - Chairman and CEO

It's not significantly better.

Rich Repetto - Sandler O'Neill

And would that be because of competition or...

Thomas Peterffy - Chairman and CEO

That's right. So when in the – in the past the markets would get very active. We were able to widen out our bid offer, our automated markets, right. This time when we try, the volume fell off. So we had to narrow it back down. So, I mean the results are somewhat better, but not significantly better.

Rich Repetto - Sandler O'Neill

And then I guess this would be my last thing. The idea that the regulatory restrictions and demands on capital, I guess at this point we're really not seeing that. We're not seeing any positive things from a competitive standpoint that we had sort of talked about in the past, that you would hope would come, impacting the other larger market makers?

Thomas Peterffy - Chairman and CEO

I don't know what you just said. But you keep talking about Market Making and our future is in Brokerage, not in Market Making. Look at focus on the Brokerage results, they are spectacular.

Rich Repetto - Sandler O'Neill

Okay. Well, then I'll ask one more question. 2 billion, it appears you had -- you said 68% of the 3 billion is in excess is in brokerage. So do you…

Thomas Peterffy - Chairman and CEO

We are not making any -- we are not doing any special dividends. We want to keep accumulating money because we think that we will have more and more opportunities in our Brokerage business to employ that capital.

Rich Repetto - Sandler O'Neill

Understood. You continue to have solid results in the Brokerage. Congrats, Thomas. And that's all I had. Thank you.

Operator

Thank you. Our next question comes from the line of Niamh Alexander from KBW. Your line is now open.

Niamh Alexander - Keefe, Bruyette & Woods

On the Brokerage businesses, which was a solid quarter and you talked about gaining momentum, the growth stats are really phenomenal in terms of growth of the clients and the margin and the activity. Where to from here? You're talking about you're seeing more growth coming in from referrals. But are there any specific markets -- you mentioned Asia, but give us a sense of maybe how far is it the markets you've penetrated versus where you could be and what kind of customers that you're targeting there? And then that's geographic. And maybe what can you share in terms of the types of clients that you see that you're getting more growth from now? Is it the advisor community? Are you starting to see more momentum from the smaller institutional clients?

Thomas Peterffy - Chairman and CEO

Well, our story is the same. It keeps growing and it keeps growing in all market segments. And yes, as far as the financial advisors are concerned, maybe we are now getting more interest from them than we used to in the past. And we have more -- the big prime brokers have tightened up on the requirements as far as who they take on as the hedge fund customers and what their minimum profit requirement is and the number of people who are getting rubbed off come to us.

Niamh Alexander - Keefe, Bruyette & Woods

So what are you doing today? I mean, are you growing maybe more aggressively on the sales side to go out and target more business institutional clients or is it kind of this is the platform and they'll come to us by word of mouth?

Thomas Peterffy - Chairman and CEO

That's basically it. This is the platform, but it's a hell of a platform.

Niamh Alexander - Keefe, Bruyette & Woods

All right, fair enough. And on to the succession planning, thank you for updating us on that. And I think you'd kind of signaled it recently. But can you help me understand like what are you going to do differently and what will Mr. Galik be doing differently? I mean leading the publicly traded company is kind of a whole different kind of a leadership role versus kind of running software into different departments. And then we, the public investors and then the analysts, don't know Mr. Galik at all. So, what can you share here to kind of further inform us on how the transition will happen?

Thomas Peterffy - Chairman and CEO

Well, the transition will happen over a long period of time. As you know, we have an executive group who has been together for many, many years. I am now 70, Milan is 48. He is I think one of -- maybe our youngest executive and also has the heaviest weight in the Group. And I mean that intellectually, not physically. And as long as I am healthy, I like what I do and I hope to stay around. But obviously over the next several years, I will become less and less and less capable. And I defer to the executive group and I defer to Milan in many decisions already. So, you can't expect any sudden drastic changes, but gradually he will take over more and more of my responsibilities.

Niamh Alexander - Keefe, Bruyette & Woods

Okay, fair enough, Thomas. And then if I could just go back to the Market Maker, I know you kind of prefer to talk about the broker because it is a phenomenal growth story. But we're seeing the -- excluding the translation and the translation is real, but excluding that, we're seeing such a big drop off in the profits and the volatility picked up a little bit towards the end of the third quarter and the first two months are very challenging for everybody. But I guess we're getting close to a point where are you happy with the breakeven business? Are you happy with maybe the next stage getting to losses in this business? Because it doesn't sound like the competitive environment is reversing and that some people are just going to squeezed out of it because there seems to be others coming into it as well. So, where's your level of comfort while continuing to remain in this business? If it gets to a point where you break even for a few quarters, you're generating losses for a few quarters, does it still pay you to stay in this business?

Thomas Peterffy - Chairman and CEO

Well, to tell you frankly, I am sort of ambivalent about it. But I have to accept the fact that many of the things that makes us such an incredibly good platform for customers is come from our Market Maker know-how, not only as far as the trading itself, but the order routing software and the understanding of the order types and how the exchanges work and the speed of execution we have to keep up with as market makers so we're able to give the same technology to our customers. I think that sets us apart. And as long as we stay in there trying to compete, we're able to impart those advantages to our customers and I think it's important. And as we get more and more institutional customers, it will become even more important.

Niamh Alexander - Keefe, Bruyette & Woods

I mean I guess in theory you could have those capabilities within the Brokerage business anyway. So it sounds like you'd be even willing to tolerate losses as long as that Market Marker expertise informs the Brokerage?

Thomas Peterffy - Chairman and CEO

Well, I don't know what losses you're referring to.

Niamh Alexander - Keefe, Bruyette & Woods

You know, if it progresses – like, it's been deteriorating, so if you get to a point where…

Thomas Peterffy - Chairman and CEO

Deteriorating? It hasn't hit losses yet.

Niamh Alexander - Keefe, Bruyette & Woods

Yes. So I guess my question is, if you get there, do you still feel like the Market Marker, the contribution from that business is enough to offset to the brokerage?

Thomas Peterffy - Chairman and CEO

It's not going to get there.

Niamh Alexander - Keefe, Bruyette & Woods

I see. Okay, fair enough. Thanks, Thomas.

Operator

Thank you. Our next question comes from the line of Mac Sykes from Gabelli. Your line is now open.

Mac Sykes - Gabelli & Company

I wanted to dig further into the prime brokerage opportunity. Just two questions here. First, what are the current prime brokerage competitive advantages? I know cost of execution is certainly prominent, but maybe some other details on that? And secondly, a lot of the big banks are discarding some of these clients for unprofitable or lower profitability due to capital reasons. I was just curious as to why if you took them on would there be a profitable advantage to you in terms of your business model?

Thomas Peterffy - Chairman and CEO

Okay. Well, the first question was -- I wish people asked one question at a time. The first question was what advantages do we have other than superior execution. For example, the stock borrow capability, we are almost as good as anybody else as far as -- almost as good as the best prime brokers as far as availability to short stock is concerned. Our interest rates are very good not only in as far as margin loans, but also in stock loans. So our stock loan is very competitive with the Goldmans and Morgan Stanleys of the world. So these are the primary advantages. Also, I think that our Risk Navigator is very good for hedge funds. Our trader workstation itself has many capabilities that other trader workstations do not have. So I think that for traders, we have excellent software, institutional traders.

Now your second has to do with why would we make money on the accounts that the large prime brokers cannot make money on, simply because we're much more automated than the large prime brokers are. And so as you see that our 63% profit margin, that our profit margin is much higher than anybody else's. So that's why we can make money on that.

Mac Sykes - Gabelli & Company

And just, I am sorry, a quick follow-up, just on the emerging hedge fund landscape. Do you get a sense that there is a cyclical balance in the industry in terms of formation in new offerings or is it being fairly steady? Just sort of any color you're seeing in terms of the industry?

Thomas Peterffy - Chairman and CEO

I didn't get, new offerings of what?

Mac Sykes - Gabelli & Company

New launches of hedge funds.

Thomas Peterffy - Chairman and CEO

I have heard some hedge funds that they're launching, but I think that happens all the time. So I have no evidence that there are more new hedge funds now than there were a year ago or that there are more initiatives now than they were a year ago. But there certainly are some.

Operator

Thank you. Our next question comes from the line of Sean Brown from Teton Capital. Your line is open.

Sean Brown - Teton Capital

Congratulations on the continued broker performance. Just a few quick questions. First one is, for broker bad debt expense, what does that come in at for the quarter?

Paul Brody - Group CFO

We’ll have details like that in the 10-Q. But it was not out of the ordinary from prior experiences.

Sean Brown - Teton Capital

Got it. So despite margin growth still very low, that’s very good to hear. Is there any color you can give on sort of credit quality or its aggressiveness in these loans in terms of the leveragability has gone up or down for you guys?

Thomas Peterffy - Chairman and CEO

So I have two things to say about, that one is that we have always had a policy of automated liquidation. So, each customer account is evaluated every minute of the day and we see it within margin tolerance and we send the signals to the customers who are coming close to the limit. And if they don’t reduce their positions, then at the moment they hit the limit we close them up. Now obviously there are some situations where stocks, especially these Bio stocks, can move 60%, 70%, 80% and in some of those cases we do end up with losses. And I mean there is not a heck of a lot we can do about that. But they aren't large. So, we look at concentration and the second thing that I would like to point out is that we have instituted an exposure fee where we examine accounts that would lose large amounts of moneys as a function of market move and at certain levels we start to charging them an exposure fee. And the larger the eventual loss may be, the larger the charge is. And that on the one hand encourages people to cut down on such exposure and on the other hand it gives us some additional income.

Sean Brown - Teton Capital

And then my last question is around the growth of the sales force that you guys discussed on the last call. If you could give some sort of update on that?

Thomas Peterffy - Chairman and CEO

Well, we have expanded -- we’ve always expanded -- we work on expanding our sales force. You see that we don’t see -- to tell you frankly, we don’t have a very good experience in looking at it. But we're certainly not giving up and we’re going to continue to do that.

Sean Brown - Teton Capital

So, sales and marketing may take other means besides just hiring sales people, it sounds like?

Thomas Peterffy - Chairman and CEO

Right.

Operator

Thank you. Our next question comes from the line of Andrew Bond from Wells Fargo. Your line is open.

Andrew Bond - Wells Fargo

You spoke about this briefly in the prepared remarks, but was...

Thomas Peterffy - Chairman and CEO

Sorry, can you speak up a little bit?

Andrew Bond - Wells Fargo

Sure. You guys spoke about this briefly in the prepared remarks, but I was wondering if you could give a little more color on what exactly was the large increase in interest income and interest expense and this is kind of a good run rate that you usually report?

Thomas Peterffy - Chairman and CEO

Well, we have for years been working on software that optimizes our stock lending-borrowing business and we are scaling new heights in that business. And we were also helped this quarter by certain hard to borrow inventory that we were able to utilize. And so I do expect our interest income to continue to increase into the future, but this past quarter may have been a stronger than expected.

Andrew Bond - Wells Fargo

And just a quick follow-up on the GLOBAL. I was wondered if you guys ever thought about changing the composition of the GLOBAL based on changes in the global economic environment or there is just something in particular that would change your thinking of how the GLOBAL composition should be?

Thomas Peterffy - Chairman and CEO

I think about it all the time, but I don't think that it will change.

Operator

Thank you. (Operator Instructions) Rob Koehn with Ivy Lane Capital, your line is now open.

Rob Koehn - Ivy Lane Capital

Hi, Thomas. Thanks for taking my call. Congrats on the great quarter. Can you talk a little bit about how you think about market share in the Brokerage business being your runway for growth going forward and who your competition is and kind of where this business -- where do you see the Brokerage business going in the next few years?

Thomas Peterffy - Chairman and CEO

Well, if you really want to know my honest opinion, I think that in 10 years we could be the biggest broker in the world, and I am not kidding, because our technology is way out ahead. And we are going to work away at it and we are – all of our emphasis is on keeping, building the technology and sooner or later they will realize what we've got.

Rob Koehn - Ivy Lane Capital

What do you think you can do to kind of help -- from a marketing perspective, you've put out some new commercials and from a marketing perspective, what can you do to kind of improve the brand recognition, the name recognition and that sort of thing?

Thomas Peterffy - Chairman and CEO

We do more advertising, we do more articles, we do more television appearances not only in the United States, but around the world, in other countries, because some forget that part of our great attraction as a broker is that our customers are global and where they can trade it globally. So, it is important for us that we are trying to brand ourselves not only in the United States but all over the world.

Rob Koehn - Ivy Lane Capital

And I think ultimately we've seen really amazing growth coming from Asia. Is there anything more you can offer on that in terms of Asian growth rates going forward and what you've been seeing in the last quarter in that regard?

Thomas Peterffy - Chairman and CEO

Well, the exceptional growth in Asia has continued in the last quarter. It certainly has grown faster than any other area. Maybe in the last few weeks I've been noticing some stronger growth from South America where we were very underrepresented in terms of number of customers that suddenly it seems to be perking up from a very low base.

Rob Koehn - Ivy Lane Capital

Interesting. And so you had been taking – they would be moving accounts from the big banks or where would you be taking share from?

Thomas Peterffy - Chairman and CEO

Most of the South America customers are with Pershing.

Operator

Ladies and gentlemen, that concludes our Q&A session for today. I would like to turn the call back over to Ms. Deborah Belevan.

Deborah Belevan - Director, IR

Thank you, everyone, for participating today. And just a reminder, this call will be available for replay on our website and we'll also post the clean version of our transcript on our website tomorrow. Thanks again for your time and have a great evening.

Operator

Ladies and gentlemen, thank you for participating in today's conference. You may all disconnect. Everyone, have a great day.