Interactive Brokers Group (IBKR)
Q2 2015 Results – Earnings Call Transcript

July 21, 2015 04:30 PM ET

Executives

- Thomas Peterffy - Chairman and CEO
- Paul Brody - CFO

Analysts

- Rich Repetto - Sandler O'Neill
- Chris Allen - Evercore Partners
- Chris Harris - Wells Fargo Securities
- Rob Koehn - Ivy Lane Capital
- Mac Sykes - Gabelli

Operator

Good day, ladies and gentlemen and welcome to the Interactive Brokers Group Second Quarter Financial Results Call. At this time, all participants are in a listen-only-mode. Later, we will conduct a question-and-answer-session and instructions will follow at that time. [Operator Instructions] As a reminder, today's conference call is being recorded. I would now like to turn the conference over to Mr. Bill Cavagnaro, Investor Relations. Please go ahead, sir.

Bill Cavagnaro – Investor Relations

Thank you, operator and welcome everyone. Hopefully by now you've seen our second quarter earnings release, which was released today after the market closed and which is available on our Web site. Our speakers today are Thomas Peterffy, our Chairman and CEO and Paul Brody, our Group CFO. They'll start the call with prepared remarks about the quarter and then we'll take questions.

Today's 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 is indicated in these forward-looking statements. We ask you refer to disclaimers in our press release. You should also review a description of risk factors contained in our financial reports filed with the SEC.

And now I will turn the call over to Thomas Peterffy.

Thomas Peterffy - Chairman and CEO

Good evening, everyone and thank you for joining us to review our second quarter performance. Our pre-tax comprehensive income for the quarter was $268 million. Of this amount $53 million was a result of the appreciation of the global against the U.S. dollar. As most of you are aware, we keep our capital in an internationally diversified basket of 16 currencies, we call the global, and as the value of that basket fluctuates against the dollar we make a profit, if it rises and vice versa when the value falls. Excluding that gain, our pre-tax profit for the quarter would have been $215 million. All-in-all it has been a good quarter given that historically and adjusting for our rapid growth, the first quarter tends to be our best one and yet we had another record in brokerage.

It seems that almost every quarter something happens between the end of the last quarter and the earnings call. And that is what everybody wants to hear about and nobody pays any attention to the rest of my story until I get to that. So let me go there right now. As you know in early July there was a great deal of volatility in the Chinese and Hong Kong markets which gave rise to two events which I need to comment on. First, some people started to circulate rumors about losses Interactive Brokers had supposedly suffered due to margin loans made to customers getting positions in Chinese and Hong Kong stocks. Please understand none of that is true.

In the course of the past several quarters we have done a great deal of work on further refining our margin setting systems which are based upon dynamic collateral valuation algorithms that restrain the amount by which we value securities with rapidly increasing prices for collateral purpose. This software had properly controlled our margin loans on these products and although we did have to make substantial liquidations and our margin loans did contract by almost $2 billion, no account has ever gotten into a negative equity position.

Second, a week ago Christopher Harris of Wells Fargo published some very astute comments about IBKR and our significant penetration of the Asian markets and consequently our exposure to the ups and downs in the mood of local investors. He said and I quote, “if IBKR's Asia growth were too slow to 10% from 40%, the brokers’ total account growth would be closer to 15% and not 20%." He is right, you can't argue with the numbers and then he adds, "if Asia represents roughly one-fourth of IBKR’s e-broker revenues, we estimate each 10% decline in that region would reduce consolidated revenue by 2%. In the grand scheme of things, this seems quite manageable but such a slowdown would prove disappointing versus investors' expectations." This is also true, but I also see another side to this coin.

IBKR is a global broker. Our special strength in addition to our technology and very low pricing is the fact that any client no matter where they are located they can trade or invest anywhere around the world. We custody the positions at no cost, and lend or borrow or exchange the currency as needed. Clients can manage their assets across currencies and asset classes, all in one account. Indeed outside of the U.S. very few of our clients open account with us just for the purpose of investing in their local markets. Most of them carry internationally diversified portfolios. As a result, when local markets are perceived as less desirable to investing, people begin to search for international investment capabilities and we experience the rising demand for our services.

So there is truth to both of these tendencies. Which one is stronger? I am not sure myself. What remains the case however is that we have so far succeeded to reach such a minute portion of our addressable worldwide audience, maybe around 6%, that any shrinkage or expansion in that target population should not have a noticeable effect on our growth at this time.

As I have explained at the Sandler conference, our prospects look very good right now. Basel III is causing the big bank primes to raise their rates in order to be able to compete with their other business segments for capital. Some of them have asked their smaller clients to go elsewhere and JPMorgan is leaving the correspondent clearing business altogether. There is also more about this from the Fed in today's news.

Simultaneously, the online brokers are withdrawing from various foreign jurisdictions due to FATCA and the ever increasing local broker regulatory burden. We have decided to take the opposite route. Given that so much of our business is automated, it is relatively less burdensome for us to build additional layers on top to accomplish the necessary surveillance, record keeping and reporting tasks. This puts us into a hugely advantageous position vis-à-vis other brokers. Extensive automation not only makes us less expensive, provides a higher profit margin and makes our work simpler and more organized, but it seems that it also helps us to comply with new rules and regulations as they emerge all over the world.

Catering to professional investors, we have always positioned ourselves between the large bulge bracket prime brokers on the one side and the retail online brokers on the other. And both are withdrawing from some of their previously claimed territories, this leaves us with a widening unobstructed avenue for expansion. While all this regulatory programming is using much of our resources we are still working on integrating and modifying Covestor, expanding our research capabilities and better tracking of cross-investing on our Marketplace where we are gaining considerable momentum.

Up to now 2,900 of our customers invested with advisors listed on our Marketplace and 58 invested in hedge funds. The IB Investor Marketplace is a great development for existing advisors who are on our platform. They can market their services to potential clients who have an IB account or have an interest in opening one. Recently, we launched a new initiative to help advisors who are not on our platform to become independent and setup their business. To do this, we introduced a Registered Independent Advisor Compliance Center which is a free online resource, which allows advisors to find solutions for key compliance issues that are part of being or becoming a registered investment advisor. It provides contact information to service providers who specialize in the RIA space, some of which we will offer discounts to IB customers. It aggregates key resources to help independent advisors.

We also started to provide our advisor clients with free professional grade websites. The advisor can choose from a set of template and add their content. We will then work with the client to tailor the end result. The client will be provided a pre-packaged website that will run on the hosting platform of their choosing.

After the advisor is set up on our platform is registered and has a live website, they need to build their business by interacting with their existing clients and signing up new ones. For this we built a free customer relation management or CRM system into our Account Management platform. This value-add feature allows advisors to manage their client interactions and client account configurations without leaving our platform. These new tools assist our advisor clients in starting up their business, marketing themselves to prospective clients through customized Interactive Brokers built websites, and on the IB Investor Marketplace and managing their client interactions.

Now I'll review our performance in the brokerage segment. Our pre-tax profits in brokerage were $188 million, up 42% from the year ago quarter and up 9% from the first quarter which I adjusted for the Swiss Franc related loss. This is again a new record but we expect to make many more of those in the quarters to come.

As you can calculate from our monthly metrics, which we release at noon on the first business day of each month, our number of customer accounts were up 18%, customer equity was up 22%, margin loans 23% and cleared DART 17% from a year ago.

Our interest income increased 34% from a year ago and 19% sequentially, and commissions increased 27% from a year ago and 5% sequentially. The sequential increase in commission income occurred in spite of the decrease in DARTs from the previous quarter as it is due to the substantial increase in the size of our average customer trades.

In market making, there is not much new to report. We have earned $30 million for the quarter just 11% more than the previous quarter and fairly in line with last year’s earnings of $28 million per quarter.

And now, I would like to turn it over to our CFO, Paul Brody.

Paul Brody - CFO
Thank you, Thomas. Welcome everyone to the call. And as usual, I’ll review the summary results and then give segment highlights before we take questions. Results of the second quarter were driven by another record performance in brokerage and modestly profitable outcome in market marking and gains on currency movements. Core brokerage results reflect strong increases in commission revenue and net interest income. Market making results which were slightly higher than the prior quarters stem from better trading gains and continued reduction in expenses.

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 weakened relative to most of the other major currencies there in the second quarter of 2015. And as a result, the currency basket in which we keep our equity which we call the global, strengthened against the U.S. dollar by 1%. OCI is a component of the total global effect and the rest is contained in other income. We estimate the total positive effect from the global on our reported earnings per share for the quarter to be $0.11 with $0.07 reported in OCI and $0.04 as other income.

Overall operating metrics to the latest quarter were flat to higher across product types versus the year ago quarter. The brokerage customer metrics were stronger in all products. Average overall daily trade volume was 1.23 million trades per day, up 14% from the second quarter of 2014. Electronic brokerage metrics continued to show solid increases in the number of customer accounts and customer equity. Total and cleared customer DARTs were up 16% and 17% respectively from the year ago quarter to down 5% and 4% respectively from the eventful first quarter of 2015.

Orders from cleared customers who clear can carry their positions and cash with us and contribute more revenue accounted for 92% of total DARTs holding steady with recent quarters. Market making trade volume is even with the prior quarter other metrics were moderately positive as volatility levels were up slightly and actual to implied volatility ratio was about unchanged this quarter. Net revenues were $387 million for the second quarter up 25% from the year ago quarter. Trading gains were $67 million for the quarter up 5% from the year ago quarter, commissions and execution fees were at $157 million, up 27%. Net interest income was $108 million up 29% from the second quarter of 2014 and brokerage produced $106 million and market making $1 million with the remainder in corporate.

Other income of $55 million, up 49% from the year ago quarter this was driven primarily by the exposure fee income in the brokerage segment and currency translation gains which are reported in the corporate segment. Non-interest expenses were $147 million, up 9% from the year ago quarter. Within the non-interest expense category execution and clearing expenses totaled $59 million, up 13% from the year ago quarter driven by higher brokerage volume. Compensation expenses were $58 million, a 9% increase from the year ago quarter. At June 30th our total headcount was 1,020, an increase of 11% from the year ago quarter and 6% from the prior year-end.

Within the operating segments we continue to add staff and brokerage and cut back in market making. About 20% of the year-over-year increase was due to the addition of staff on the purchase of Covestor which closed during the second quarter.

As a percentage of net revenues total non-interest expenses fell to 38% from 44% in the year ago quarter. Out of this number execution and clearing expense and compensation expense each accounted for 15%. Our fixed expenses were 23% of net revenues. Pre-tax income was $240 million up 38% from the same quarter last year and for the quarter ex-currency effects brokerage accounted for 86% and market making accounted for 14% of the combined pre-tax income.

For the second quarter our overall pretax profit margin was 62% as compared to 56% in the second quarter of 2014. Brokerage pre-tax profit margin was 65% up from 59% in the year ago quarter and market making was 42% up from 37% in the year ago quarter. Comprehensive diluted earnings per share were $0.44 for the quarter as compared to earnings of $0.29 for the second quarter of 2014, and excluding OCI diluted earnings per share were $0.37 for the quarter as compared to $0.26 for the same period in 2014.

To get a better understanding of the progression of our business we find it helpful to isolate the core operating results. So, for the quarter excluding the currency effects, our core results were as follows; net revenues were $362 million up 25% from the year ago quarter. Pre-tax income was $215 million up 39% from the same quarter last year. Overall pre-tax profit margin was 59%, up from 53% in the year ago quarter and diluted earnings per share were $0.33 in the quarter as compared to $0.23 on the same basis for the second quarter of 2014.

Turning to the balance sheet, as a result of the growth of our brokerage business and the continued withdrawal of capital from our market making operations through regular and special dividends brokerage now accounts for about 80% of our combined balance sheet assets from the two segments. From the year ago quarter, cash and securities segregated for customers rose 8% and secured margin lending to customers rose 24%, while positions and securities held by our market maker units were paired back by 5%.

According to our announced policy, regular quarterly dividends will continue to temper the capital employed in the Market Making segment. In the second quarter, our market marking earnings fell short of these amounts 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 securities 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 June 30th, we maintained over $3 billion in excess regulatory capital in our broker dealer companies around the world, of which about 70% is in the Brokerage segment. We continue to carry no long-term debt. And our consolidated equity capital at June 30, 2015 was $5.23 billion, of which approximately $3.3 billion was held in Brokerage, $1.8 billion in Market Making and the remainder in the corporate segment.

The segment operating results, are summarized in the earnings release and will be more fully detailed in our quarterly 10-Q report, so I will just highlight the noteworthy items. Starting with Brokerage customer trade volumes were up across all product types, cleared customer contract and share volume was up 14% in options, 27% in futures and 72% in stocks. Much of the stock volume increase came from trading in low priced stocks and in particular from a surge in volume in Hong Kong. Foreign exchange volume also increased from the year-ago quarter.

Customer accounts grew by 18% from the total at June 30, 2014 and by 5% in the latest quarter. Total customer DARTs were 616,000 up 16% from the year-ago quarter and down 5% from the record level reached in the first quarter of this year. Our cleared customer DARTs were 555,000 up 17% in the year-ago and down 4% from the prior quarter. The average number of DARTs per account on an annualized is 469 down 1% from the 2014 period and 9% sequentially. Commission revenue growth on a product mix that featured larger average same prices in stock options and futures, an indication of greater activity from professional and institutional customers. This resulted in an overall average cleared commission per DART of $4.31 at a quarter higher by 8% from the year-ago quarter and 6% sequentially. Note that commissions include exchange fees which can vary widely.

Customer equity grew to $66 billion up 22% from June 30, 2014 and up 8% sequentially well outpacing the S&P 500 Index which rose 5% over the past year and was relatively unchanged over the last quarter. The source of this growth continues to be a steady inflow of new accounts and customer assets and to some extent customer profit. Margin debits continue to build steadily increasing 23% over the year-ago quarter. Customer credit balances also continue to grow progressively increasing 19% over the year-ago quarter so spread compression persists in restraining net interest income.

Higher trade volumes resulted in top-line revenue from commissions and execution fees of $157 million, an increase of 27% from the year-ago quarter and 5% sequentially. These revenues are spread mainly across options, futures, stocks and foreign exchange. Net interest income rose to $106 million up 34% from the second quarter of 2014 and up 19% sequentially. Low benchmark interest rates which continue to compress the spreads earned by our brokerage unit generally have been offset by steadily higher customer credit balances 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 are 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 was 37%, as our brokerage revenues are maintaining diversifications between commissions and net interest income. With the growing customer asset base we believe we’re well positioned to benefit from a rising interest rates. Based on current balances we estimate that a general rise in overnight interest rates of 25 basis points would produce an additional $46 million in net interest income annually.

Further increases in rates will produce smaller gains because the interest we pay to our customers impacts the benchmark rate plus the narrow spread. Execution and clearing fee expenses increased to $41 million for the quarter, up 17% from the year-ago quarter on higher trading volumes on all product classes and up 5% sequentially. Fixed expenses were $60 million up 9% on the year-ago quarter. Pretax income from electronic brokerage was $188 million for the second quarter up 42% in the year-ago quarter and 269% on the first quarter which included customer bad debt losses related to the Swiss National Bank event.

Turning to market makings, market making trade volume was unchanged from the prior year quarter, contract volumes were down 5% in options and 11% in futures while stock share volume was up 51% and as in brokerage much of the stock volume came on greater activity in Hong Kong. Trading gains from market making for the second quarter of 2015 were $67 million up 5% from the year-ago quarter. Pre-tax income from market making was $30 million for the quarter up 15% from the year-ago quarter. Execution and clearing fees expenses rose to $18 million for quarter up 6% from the year-ago quarter driven by higher trading volumes and stock.

Fixed expenses were $24 million down 14% from the year-ago quarter primarily due to employee compensation. We continue our aggressive expense management as we monitor the performance of the market making business. Looking at the corporate segment earnings reported for the corporate segment reflects the effect of our currency diversification strategy our overall equity is measured in U.S. dollars increased by the weakening of the U.S. dollar against other major currencies more specifically we estimate the overall gain from our strategy of carrying our equity in proportion to the basket of currencies we call the global to be about $53 million for the quarter because $28 million of this gain is reported as other comprehensive income this leaves a gain of $25 million to be included in reported earnings. This is the primary component of other income in the corporate segment.

Now, I'll turn the call back over to moderator and we will take questions.

Question-and-Answer Session

Operator
[Operator Instructions] And our first question comes from Rich Repetto of Sandler O'Neill. Your line is now open.

Rich Repetto - Sandler O'Neill
Good evening Thomas, good evening Paul and congrats on the strong brokerage quarter again, I guess the question that comes up is and you did mention $2 billion of margin loan, and I believe you said from China, is there any way else you could break out of your -- you have given metrics on Asia but specifically the China impact whether it'd be DARTs or accounts and or whether it'd be through the Shanghai, Hong Kong stock connect program to judge the impact of the Chinese I guess slowdown in the market?

Thomas Peterffy - Chairman and CEO
I didn't say that it came from China, but it happened at the time that the Chinese market fell. Look, Rich, I don't think we should disclose too much of this information. After all this is a competitive marketplace and we disclose a heck of a lot more than any of our competitors do.

Rich Repetto - Sandler O'Neill

Sure and I guess the question though is, given what's going on in the Chinese market and say movements in the metrics like you've mentioned on the margin loans, like how would we expect I guess the coming quarter would we expect to see the same sort of growth rates, if there, if sort of the run rates coming out of the quarter then that reflect China, would we see a significant slowdown in the brokerage growth rate I guess this is the question?

Thomas Peterffy - Chairman and CEO

So Chris Harris' numbers were pretty much correct, I am not saying, first of all we have customers all over the world and many of them trade in Hong Kong even though they are not Chinese customers, right. So we have not actually broken out how many of our customers that borrow money against Hong Kong stock are actually Chinese customers.

Rich Repetto - Sandler O'Neill

Okay. I guess my last question Thomas is again you've mentioned this and the whole growth from small institutions and hedge funds that you've seen as some of the other primes pull back and I guess is there any way -- I think we all saw the increase in the average stock order size et cetera, is there any other way we can gauge and get a feel for how that growth is going given that JPMorgan is existing the business, is there any other metrics either you or Paul can give that can give us a better feel for how many -- how fast we're growing in these bigger I guess more institutional type accounts?

Thomas Peterffy - Chairman and CEO

We publish our monthly metrics, right, but you see there the number of new and the number of net new accounts and you see the amount of net new deposits, right? So you have to gauge it from that. We're really not looking to break it out in any finer degree than that.

Rich Repetto - Sandler O'Neill

Okay. And one last one for Paul, in this other income revenue line, Paul, there has been gains on investment both I believe it is this quarter, I know that was last quarter as we looked in the Q. And could you explain that a bit, is this and I think it related to hedging activity these gains in the other income line, could you go through that a bit?

Paul Brody - CFO

Sure, while the primary -- since we've changed the presentation in our accounting in the fourth quarter the primary component of other income is the currency translation effect. And so as we described that this quarter that's about $25 out of the $53 million and it all goes to other income there. We did that to make it a much more straightforward presentation for folks like you perhaps because you're asking the question that it is not quite as straightforward as it might be. If there are some other components to it as I mentioned it's a collection of the exposure fees one of the ways that we approach risk management to allow customers to cut their risk or to perhaps take somewhat greater risk at a greater cost to them and the greater income to us. So, these are all components but by and large to the largest one of these days is the currency translation.

Rich Repetto - Sandler O'Neill
Yes. Okay I guess yes if you might you can subtract $20-$25 off of their well it is still $30 and generally higher than the run rate in the past but anyway we can follow up on the question afterwards but again congrats on.

Paul Brody - CFO
We would expect to give you little more color on that in the upcoming 10-Q.

Rich Repetto - Sandler O'Neill
Okay. Congrats on again Thomas the strong-strong brokerage growth for the quarter.

Operator
Thank you. And our next question comes from Chris Allen of Evercore. Your line is now open.

Chris Allen - Evercore Partners
Good evening guys, so, I guess if you could just start out in the -- your latest investor deck it noted that 42% of commissions are -- through April 15th came from Asia Pac…

Thomas Peterffy - Chairman and CEO
Sorry. Where did you get that?

Chris Allen - Evercore Partners
From your Sandler O' Neil presentation.

Thomas Peterffy - Chairman and CEO
Who pointed out that 42% of the commission?

Chris Allen - Evercore Partners

I am sorry I mis-quoted 23.6% of revenues.

Thomas Peterffy - Chairman and CEO

Okay. That I can believe.

Chris Allen - Evercore Partners

I apologize. I'm just wondering through April 30th it was 23.6% Paul you noted elevated activity at Hong-Kong I am just wondering if that was a dramatic increase in overall 2Q relative to that run rate through the end of April?

Thomas Peterffy - Chairman and CEO

Yes. So, first of all so roughly 25% of our accounts are from Asia and 25% of our commission derives from those accounts, those are very good numbers they are good within in 3% either way.

Chris Allen - Evercore Partners

Okay, all right. And then...

Thomas Peterffy - Chairman and CEO

As I tell you most of those commission dollars are a result of those accounts trading in the U.S. and to some extent in Europe.

Chris Allen - Evercore Partners

Got it, okay. And then Thomas you noted that right now you’re penetrating about kind of 6% of your addressable market I mean any metrics you can give us in terms of how you arrived at that number?

Thomas Peterffy - Chairman and CEO

Well. We are guessing that 5 million to 6 million people would benefit unquestionably by having their account of Interactive Brokers and these are people who are financially sophisticated people who are, who care about their quality of execution and their trading cost and financing costs. So, we have just moved up how many people in the different countries would qualify roughly for that sort of, who are trading as professionals. Not necessarily for their own account but also for institutions. So, for example if you ever have an online account, an online brokerage account you would be one of those 5 million to 6 million people who would benefit from adding your account with us.

Chris Allen - Evercore Partners
Got it. And then not to continue on the Asia trend but in the fourth quarter you noted that these are the Far East is ramping at faster pace in the geographies and does that continue to be case right now are you seeing any impact there?

Thomas Peterffy - Chairman and CEO
We did not see any… Hong-Kong trading volume slowed to some extent, but we haven't seen any bad debt as far as new accounts or new money spend surge in from Asia.

Chris Allen - Evercore Partners
Okay. Then the last one from me what was the impact in rough numbers from Scottrade and Motley Fool in terms of account growth during the quarter and then just a kind of that is the big one kind of transfers kind of over and it's more kind of organic knows venues now?

Thomas Peterffy - Chairman and CEO
I think the case is the latter and also they have asked us not to talk about it.

Operator
Thank you. And our next question comes from the Chris Harris of Well Fargo. Your line is now open.

Chris Harris - Wells Fargo Securities
Another follow up on Asia if I may, this is a pretty big decline in your margin balances and really Thomas you've been in the business for a very long time and this occurs periodically obviously and specially in some of the markets that you guys operate in. What has been the impact on investor psychic when you have something of this magnitude impact a region or an area I'm just particularly wondering about how those customers in that region might react?

Thomas Peterffy - Chairman and CEO
They have already reacted to it in the sense that they contracted their borrowings and some of those borrowings were contracted by us because of the margin violation. So this happens all the time, when market go down people are borrowing money to a lesser extent.

Chris Harris - Wells Fargo Securities

But no impact on trading activity or account growth and what I really find curious is that you are getting a loss or taking a haircut on some positions in one region why that wouldn't impact your behavior in another region. So you mentioned your Asian customers trade a lot in the U.S. and Europe and wondering why if they are taking substantial losses in Asia why that wouldn't bleed into activity in other parts of the world?

Thomas Peterffy - Chairman and CEO

First of all our customer base is more sophisticated than the average brokers'. So our customers are not necessarily long the market. Many of them trade options, many of them are short, many of them run a long-short portfolio, secondly we're extremely well diversified and in some places the market goes down and in other places goes up and there isn't -- other than the sudden margin contraction there I didn't see a huge impact as far as trading volume or new account openings of new money coming in. It's not a big impact I wouldn't worry about it, or let me say I'm not worried about it.

Chris Harris - Wells Fargo Securities

Wondered maybe switch to another topic and perhaps I mis-read or I am mis-quoting you here Thomas but I think at a recent event you had downplayed that there was a lot of excess capital available potentially for investors. I just want to give you a chance to comment if that's indeed the case and if it is why that is the case?

Thomas Peterffy - Chairman and CEO

You mean that we have a lot of excess capital?

Chris Harris - Wells Fargo Securities

Correct, yes.

Thomas Peterffy - Chairman and CEO

Well we have always had a lot of excess capital and we aim to have that even more in the future. I think that all the banking regulations that are growing on both from the Basel III and from the Dodd-Frank are playing into our hand and they are, we can pick up a lot of this business and I think we can use the capital well.

Chris Harris - Wells Fargo Securities

So more of the healthy organic growth of the business than there being some massive distribution you may or may not want to make to investors?

Thomas Peterffy - Chairman and CEO
I very plainly said that we're not looking at making any distributions other than our regular quarterly $0.10 dividend.

Chris Harris - Wells Fargo Securities
And then a quick question on the P&L. You guys have run this fairly low tax rate for some period of time and I'm just trying to think for modeling purposes is it fair to sort of use this sub 10% GAAP tax rate on a go forward basis or is there some benefit that rolls off that we should be thinking about for future quarters?

Thomas Peterffy - Chairman and CEO
Paul?

Paul Brody - Group CFO
Well yes the original benefit embedded in the IPO transaction is a 15 year benefit and our IPO was in 2007, that kind of benefit, though we have nothing planned, that kind of benefit would be increased in renewed with each additional of any secondary offerings where the sale price was in excess of essentially the book value really the tax cost basis but call it the book value that is what generates that tax benefit, so each one of those is a 15 year amortization, so last for quite a well.

Thomas Peterffy - Chairman and CEO
Paul that includes employees selling unregistered shares also, right?

Paul Brody - Group CFO
Yes, each time shares are sold into the public.

Thomas Peterffy - Chairman and CEO
And including bonus shares right?

Paul Brody - Group CFO
Not including bonus shares.

Thomas Peterffy - Chairman and CEO

Not including bonus shares. Okay so the shares that are originally owned shares that become a newly registered, yes?

<u>Paul Brody</u> - Group CFO
Yes, correct.

<u>Chris Harris</u> - Wells Fargo Securities
OK, thanks for clarifying.

<u>Operator</u>
And our next question comes from Rob Koehn of Ivy Lane Capital. Your line is now open.

<u>Rob Koehn</u> - Ivy Lane Capital
First question would you able to provide some more clarity at least directionally around the top firms that ACAT accounts into Interactive Brokers in other words presumably you see the ACATS data every day or every week and where those accounts coming from largely is it the Fidelity’s and JPMorgan’s or Schwab’s?

<u>Thomas Peterffy</u> - Chairman and CEO
It's always two groups. It's the four big online brokers and the four big banks. So it's Schwab, Ameritrade, Fidelity and E-Trade, on the one hand and JPMorgan, Goldman and Morgan Stanley and to some extent Citibank the other and Pershing.

<u>Rob Koehn</u> - Ivy Lane Capital
And are you seeing more with the mini-primes tightening their belts so you're seeing more from…

<u>Thomas Peterffy</u> - Chairman and CEO
We wouldn't see the mini-primes, we see them as the big banks because for the mini-primes the big bank is where the ACAT comes from.

<u>Rob Koehn</u> - Ivy Lane Capital
Right, so I was going to say Goldman Sachs, Goldman Sachs execution and clearing being one of those.

<u>Thomas Peterffy</u> - Chairman and CEO

Yes, Goldman is one of the names I mentioned, yes.

Rob Koehn - Ivy Lane Capital
Okay and then to follow up the Sandler conference, you talked about the brokerage business generally, and the fact there are hundreds of brokers out there out there. Everybody is doing the same thing back office, stock lending, executions and dealing with regulatory burdens and eventually the best platform would have to end up with the majority of the business. I wanted to see if you could talk some more about that and maybe also from the perspective of banks and brokers that could become introducing brokers to you, so what is the math look like to them. I mean are they even profitable in this area, are they able to cut out substantial amount of R&D expense presumably headcount and they able to go from marginally profitable to significantly profitable in an introducing relationship or how does that work?

Thomas Peterffy - Chairman and CEO
To tell you frankly I do not understand how it is possible that many of these folks are still in business. I mean the only way that it is possible is that they're charging very high commissions and very high financing rates because their technology is very, very poor and it's expensive for them to run it and they have future regulatory issues. So I think that as time goes on more and more of them will realize that they save a great deal of money by coming onto our platform and dispensing with their own. As soon as they realize that we're not going after their customers, their fear is that the customer will leave them and come here, of course that will only happen if they really become lazy and they just put their name on it and don't service the customers. And their customers then think that well maybe we better go to Interactive Brokers because my broker doesn't do anything for me. But given that we have that fear the commissions in which the customer is charged based on his volume, and their brokerage, and we charge the broker based on all their customers volume. So even if they go out to their customer with our charges they would and it is my belief, make more money than they currently do.

Rob Koehn - Ivy Lane Capital
Right okay and I noticed that a couple of different from the marketing perspective that a couple of your introducing brokers actually kind of use your, used Interactive Brokers Barron’s ratings and awards in their own marketing you know basically saying and used they have the top rated technology, so do you guys have a, I guess differently -- do you have a specific group of sales

people that go and call on global banks and brokers for introducing business or how proactive are you about generally…?

Thomas Peterffy - Chairman and CEO
We have about -- we have not about, we have exactly 34 sales people today who are located on the three continents where we are active and they go around and they talk to introducing brokers and hedge funds and wealth managers and that's what they do.

Rob Koehn - Ivy Lane Capital
Which seem like that's a very senior level decision in a lot of these firms and then I am just wondering whether the sales people are senior enough to go out and talk to the right people to win that business?

Thomas Peterffy - Chairman and CEO
It's not a difficult situation because there is basically we have no competitors. Nobody else is seems to be operating the same thing other than maybe Saxo Bank right. And Saxo Bank is a very small $1 billion Danish Bank and they're the only ones who compete with us on this so.

Rob Koehn - Ivy Lane Capital
Okay.

Thomas Peterffy - Chairman and CEO
It is not a difficult sales job.

Rob Koehn - Ivy Lane Capital
Okay, okay. And I guess one last thing on Asia how big I mean I guess Asia is obviously Japan and I guess Australia is in there it's a pretty broad category if you somebody may have asked this question differently have you thought with that kind of breaking out Asia, mainland China just from the rest of Asia?

Thomas Peterffy - Chairman and CEO
No. We did not break out mainland China from the rest of Asia and as I've said Asia constitutes roughly 25% of our account and 25% of our commissions.

Rob Koehn - Ivy Lane Capital

And is it fair to say that you have said a couple of quarters back that the Hong-Kong, Shanghai connect has not really been a very successful product.

Thomas Peterffy - Chairman and CEO
Yes it has picked up it seems it is used much more than it was soon after it came up.

Operator
Thank you. And our next question comes from Mac Sykes of Gabelli. Your line is now open.

Mac Sykes - Gabelli
My first question is actually for Chris Harris. Actually more recently we've seen we think might of the growth in the global reach Virtu I'm sure you saw the IPO recently and just listening to their commentary and results probably we believe there is still pretty significant opportunity using technology on a global basis within trading markets. I was curious if you maybe you can just comment on those success and maybe being able to emulate some of that what they are doing in terms of using your technology?

Thomas Peterffy - Chairman and CEO
You are asking me or you are asking Chris Harris?

Mac Sykes - Gabelli
I'll stick to you if that's okay thanks.

Thomas Peterffy - Chairman and CEO
Well. Look we do not we can guess what Virtu is doing but we do not know for sure and that is the type of trading that we never focused on because our idea always has been that we will supply liquidity and we will get paid for it. And by supplying liquidity what we have in mind was supplying liquidity for hours and days, so our average turnover is our average position is open for five days. They on the other hand go home flat everyday so it's a very-very different business and what do I think of it? I hope that it is but I really think of it is but it's not a socially beneficial activity but it's a free country so it's not something that we would what we want to do.

Max White - Gabelli
And my last question is just to accumulate global aspect of your platform and obviously leveraging on the Internet and can you just comment on cyber security and so how do you feel

about that spending maybe your attitude how do you protect the customer assets and files and so on, if you seeing an increase there or just [Multiple Speakers].

Thomas Peterffy - Chairman and CEO
We are extremely security conscious and even more worried as we are many of our, we have lost many accounts based on the idea that we want the two factor authentication and we have more kinds of others security barriers that we often people just throw up their hands and say yes I don't want to have to deal with this and they go away, but I think that security is a very-very big issue and I'm not as much worried about ourselves but I'm worried about the entire infrastructure and what happens if that comes down so we have our backups we are continuously testing it to make sure that it is operational but I'm afraid of what would happen if the whole Internet came down or if the banks operations got disrupted or all kinds of things can happen.

Operator
Thank you. And our next question comes from Chris Allen of Evercore. Your line is now open.

Chris Allen - Evercore Partners
Hi guys I just had a one follow up. On the $2 billion in margin loans that came out after the quarter trying to gauge the impact on brokerage NII I would guess that it is little bit higher margin rates and through overall would that be kind of correct just trying to think about the NII over margin loans and just extrapolate that forward?

Thomas Peterffy - Chairman and CEO
You mean that those rates are higher than -- no all of our rates are the same.

Chris Allen - Evercore Partners
Got it, okay.

Thomas Peterffy - Chairman and CEO
So we're always benchmark plus anywhere between 0.5% and 1.5% depending upon the amount borrowed.

Chris Allen - Evercore Partners
So it is simply just taking the balances out and assuming some growth rate on ex that?

Thomas Peterffy - Chairman and CEO

That’s right, but also I don't expect those margins to continue at the diminished levels forever either.

Operator

Thank you. And I'm showing no further questions at this time. I would like to turn the conference back over to Mr. Cavagnaro for any closing remarks.

Bill Cavagnaro - IR

Thank you everyone for participating today. Just a reminder, this call will be available for replay on our Web site. We will be posting a clean version of our transcript on our Web site tomorrow. Thanks again for your time.

Operator

Ladies and gentlemen, thank you for participating in today’s conference. This does conclude the program and you may all disconnect. Have a great day everyone.