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THE WALL STREET TRANSCRIPT
Connecting Market Leaders with Investors

Interactive Brokers Group, Inc. (NASDAQ:IBKR)

THOMAS PETERFFY has been Chairman and CEO of Interactive Brokers Group, Inc., since its inception. Mr. Peterffy was born in Budapest in 1944. He attended The College of Surveying before immigrating to the United States in 1965. While continuing his studies at NYU, he worked as a computer programmer. In 1969, he became a vice president of Mocatta Metals Inc., where he created and managed computerized trading systems in the commodity markets. In 1977, he joined the American Stock Exchange as an independent floor trader and formed the company known today as Interactive Brokers Group LLC, which specializes in the building and deployment of automated trading and brokerage systems for professional traders and investors worldwide. He is widely considered a pioneer in the advancement of options markets and electronic trading.

SECTOR — FINANCIAL SERVICES

TWST: You last spoke with TWST in 2014, how has your vision changed since then?

Mr. Peterffy: The ultimate vision remains the same: to build technology to perform broker/dealer functions and services at a lower cost than anyone else does, and to provide our customers with new and unique trading and investment tools that give them an edge over the customers of other brokers.

TWST: You were recently cited by an analyst we interviewed as one of the investment brokers that has best tapped into the Chinese market. What has been the secret to your success?

Mr. Peterffy: The platform and services we offer in China are the same offered everywhere else. What is different in China and in all other emerging economies is that many individuals and institutions are facing the investment challenge for the first time, and accordingly, they are choosing a broker for the first time. They compare our commission and financing charges, our technology and our reputation to everybody else's, and most often, they choose us.

In the U.S. and in Europe, we are relative newcomers to the industry, and most people already have a brokerage account. They are not looking for a new broker. Even though we are trying to convince these people that the benefit of switching over to us would be well worth the effort, it is difficult to overcome the natural inertia. To illustrate this point, we charge an average of 1.13% interest on margin loans, while other brokers charge anywhere between 3% and 8%. You would think that most people who use margin loans would be with us, but that is not the case. Inertia is the greatest barrier for us to overcome.

TWST: In the past few years, what would you say has been the most disruptive technology for brokerage firms, and what challenges and benefits has this posed for your company?

Mr. Peterffy: Mobile trading comes to mind. We brought our mobile trader to the market about three years ago on the iPhone and Android devices. We have been working on refining and expanding the applications ever since. We have a long runway ahead of us in mobile applications, but as you know, this is a competitive industry, and there is no point in discussing applications until we are ready to bring them to market.

TWST: You have broken into the top ranks of online brokers, being cited by Hedgeweek as number 14 in *Modern Trader's* list of the top-30 brokers, and with *Barron's*, you had the number-one spot for the fourth year in a row. What do you think differentiates you from your peers, and how have you achieved this breakthrough, apart from nonstop technological innovation?

Mr. Peterffy: The *Modern Trader's* list of the top-30 brokers is sorted in order of customer funds in commodity accounts. One of the unique features our platform provides for is the ability to trade securities and commodities and foreign exchange in the U.S. and in most foreign markets from one consolidated account on one screen. That is what the customer sees, but of course, in the background, we have different accounts in which customer funds are segregated.

Most of our customers who carry securities portfolios also have, from time to time, futures positions because futures are easier and less expensive to use for hedging purposes. We give these customers the option to sweep excess funds from their commodity accounts to their securities accounts on a daily basis, and most of them do elect that option in order to receive SIPC coverage for those funds. Accordingly, our ranking on the top-30-brokers list is understated, because without that option, our customers' funds would be much higher.

As to your question of what has kept us on the top of *Barron's* ranking of online brokers for the past four years, and what differentiates us from other brokers? You are correct; it is our relentless focus on building automation. This is our 39th year as a company run by computer programmers. That is what we do best, so that is what we focus on. Other than that, we pay much more attention to growing our customer base and our customers' profitability over the long term than our quarterly financial results. Because approximately 84% of our stock is held by our employees, we can afford to do that.

TWST: How does the recent acquisition of Covestor support your business strategy?

Mr. Peterffy: Covestor enables Interactive Brokers' customers to invest along with selected RIAs or hedge fund managers who are also on our platform. The great thing is that the trades are done in each client's account automatically, and the manager does not have any administrative responsibilities. The manager just trades his own account, receives his management fees automatically and needs to pay no attention to his followers.

It has taken us a relatively long time to incorporate this capability into our platform for two reasons. First, we had to build a partitioning capability. Assume that you have an account with us with $300,000. You can now partition the account into, say, three subaccounts. The first $150,000 you manage yourself, $60,000 you assign to follow a specific Covestor RIA, and the remaining $90,000 you assign to another Covestor hedge fund manager. All these monies are in your account at all times, and you can keep an eye on the equity in your three subaccounts. You pay the managers a fee that is periodically and automatically deducted from your account and transferred to the manager's account.

The other issue we had to solve was slippage. When you follow somebody else's trading, he trades first, and you trade second, and he will usually get a better price than you will due to market impact. We needed to make sure that this does not happen. We needed to build technology to execute all the managers' and the followers' orders together and allocate them at the same price. We recently finished both of these projects and are ready to go.

TWST: What do you think will be the most significant impact of robo-advisers on the industry, and how do you plan to keep abreast with the trend?

Mr. Peterffy: Robo-advisers are just a cheaper form of automatically managed mutual funds, and you can't lump them together. Their popularity will, to a great extent, depend on their individual performance. Our Covestor solution can be looked upon as a more sophisticated robo-adviser.

Another similar facility we recently brought to market is our Portfolio Builder. Our customers can screen stocks based upon specific fundamental and technical data combined with stock rankings provided by many research organizations to our platform. Clients also have the ability to assign different weights to these various data points and to assemble long, short or long/short portfolios, and to periodically rebalance them and backtest them. Once a portfolio is optimized by the client, she can assign it to a partition of her account and let it trade automatically. This is the ultimate robo portfolio manager. This is all very easy to do on our platform, and you do not even have to have an account with us to try it. You can open a free demo account and see how it works.

TWST: What regulatory challenges do you see as being most irksome in 2016, and how do you plan to address them?

Mr. Peterffy: Perhaps the greatest regulatory challenge comes from the fact that there are numerous regulators and they are not coordinated by anyone. As a result, situations may arise when several regulators at the same time ask for extensive records and make other very time-consuming demands with short, identical deadlines.

TWST: What would you say might be the most significant business challenges apart from regulatory ones that will be seen in the investment brokerage industry, and how are you preparing for that?

Mr. Peterffy: The largest impact on the industry is due to Basel III calling for less leverage at the large banks. As a result, the big bank prime brokers are becoming more selective as to which of their customers they will continue to service, what minimum requirements they ask those customers to fulfill and how much they raise their charges to justify the allocation of capital to them. This happens to be a very favorable development for us as many brokers and hedge funds are now looking for alternative prime brokers and custodians who can service them at a lower cost, and we are it. This is a typical example of how "luck favors the prepared."

TWST: Are you happy with your balance sheet at this point, and are there any areas that you're working to improve?

Mr. Peterffy: We have $5.5 billion of shareholders' capital and no debt. This is more than sufficient, but we are working on boosting it further by the addition of retained earnings.

TWST: Do you have a plan in place to protect the margin and reduce costs this year?

Mr. Peterffy: No. Our margin will increase as the business scales up. We are adding costs by increasing technology, regulatory and marketing spending at a measured pace, just as we have done for decades.

TWST: What is your vision for the company in the next five years or so?

Mr. Peterffy: Five years from now the industry will have fewer and technologically more advanced participants, with Interactive Brokers among the most reputable.

TWST: Thank you. (KK)

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