GROUP

IG Group plc

Full Year Results

Tuesday 18th July 2017

Paul Mainwaring, Chief Financial Officer

Good morning everyone, and welcome to the IG results presentation for the year to 31 May 2017. I'm going to take you through the usual overview of our financial performance and position, and then Peter will take you through more detail on the performance and development of the business, our views on the rapidly changing regulatory environment, and our future plans. After that there will be an opportunity to ask questions, and Kieran McKinney will coordinate that session. Before we start, I draw your attention to the disclaimer on page 2 of the slide pack.

The first slide for me on page 4 summarises the results for the financial year. Market conditions were not particularly favourable, and in that context we are pleased to present results that show good growth in revenue, a good profit margin, and good cash generation. Net trading revenue of £491.1m is 8% higher than in the prior year, with profit before tax up 3% at £213.7m, which reflects the investment we've made in marketing and in other initiatives to drive future growth.

Profit after tax of £169.2m, and our diluted earnings per share of 45.9p are also both 3% higher than for FY16. We've continued to generate strong cash flow from our profits with £183.9m of net own funds generated from operations in the year. And we're proposing a full year dividend of 32.3p per share, which gives a final dividend of 22.88p per share. That level of full year dividend is in line with our policy of paying 70% of earnings as dividends.

Slide 5 shows the income statement for the year in more detail. The 8% increase in net trading revenue, which I'll take you through in a moment, drives the 9% increase in net operating income. The growth in net operating income benefits from a lower level of betting duties in FY17, which reflects a lower level of client losses on spread betting. The long-term average for betting duties as a percentage of net trading revenue is around 2%, which is the rate I would suggest you use in your projections.

We do continue to earn a small amount of net interest on segregated client funds, the average net rate we earn has come down, but we have seen a significant increase in average client money balances which has more than offset that effect.

Operating expenses have increased by 14% to £276.1m, and I'll talk more about operating expenses in a moment.

The effective rate of tax for FY17 is 20.8%, as we projected at the half year. The effective rate is slightly lower than the rate for FY16, largely reflecting the reduction in the rate of UK corporation tax to 19% from 20% on 1 April this year. Taking that into account, and the other moving parts in our tax charge, we estimate that the effective rate of tax for FY18 will be around 20.5%.

We have seen a significant depreciation in sterling against all of our other major operating currencies this year, and I know that some of you have asked about the impact that changes in FX rates has on our revenue and profit. Now we have given a lot of thought to how we can answer that question, but we have concluded that we can't. Our net trading revenue is the aggregate of many millions of client trades and our hedging with the market and currency exposure, and client trades can be in the natural currency of the market they're trading or in their account currency, and with all those transactions booking in sterling it simply isn't practical or even that meaningful to seek to isolate the changes in FX rates on revenue. We can identify the effect on our costs, but as we can't do so on revenue we accept that we manage our earnings in sterling and report and explain our results accordingly.

This next slide shows more detail on the 8% increase in net trading revenue. You will be aware from the statement this morning that we have refined our segmental reporting to reflect how we manage and assess the business internally, and that we have also changed the definition we use to determine who is an active client. That latter change makes very little difference to the OTC leveraged trading client numbers, and no difference for the US, but it does give us a much better metric for share dealing and investments, and also highlights the number of multi-product lines who are both in a leveraged trading account and a share dealing or investment account, and who we deduct to get the total number of group clients to avoid double counting.

OTC leveraged revenue was up 7% at £474.6m, which is driven by a 7% growth in number of active clients, with revenue per client little changed at £3,200. Our UK revenue was flat and the number of active clients is up 8%, but the drop in revenue per client offsets that. These UK metrics reflect the heavy client acquisition around the UK's EU Referendum, and the US Presidential Election, and the low level of volatility.

In EMEA our revenue was up 17%, and this region divides into two broad areas when analysing performance. Like the UK, the EU based offices are more mature and have seen a slower rate of growth than the newer non-EU offices of Dubai, South Africa, and Switzerland where revenue almost doubled.

In APAC the growth in active clients was more modest at 3%, and with revenue up 9% boosted by an increase in revenue per client. All the revenue in the USA comes from exchange traded derivatives. We continued to see strong growth in client numbers for Nadex, up 47%, with revenue up 26%. In share dealing and investments we had over 20,000 active clients at the end of the year, and whilst the absolute amount of revenue is still small from these products, they do provide another important aspect to our relationship with clients which we believe will have a significant longer-term benefit.

The chart on the right of the slide shows the make up of the OTC leveraged revenue by asset class. Unsurprisingly given the relatively low level of volatility in equity markets and the opportunities in products such as oil, the mix of revenue has shifted away from equity indices and towards commodities.

The next slide on page 7 shows you the bridge of how OTC leveraged revenue has increased from year to year. The pattern of growth in FY17 is similar to that seen in FY16, except that in FY17 we saw a reduction in the year-on-year level of trading from existing clients, which is due to the lower level of volatility compared with the year-on-year increase in FY16.

Each year we experience a number of clients who stop trading, and the relative impact on revenue from such clients is the same in both years. In each year that is more than offset by the revenue from clients who return to trading, and particularly from new clients who traded for the first time in the year. In FY17 our new clients accounted for £86.7m of revenue, and that compares with the £64.5m we spend in total on external advertising and marketing and those clients will continue to generate revenue in future years. We will discuss advertising and marketing spend in more detail during the presentation.

The chart on the right shows the number of active clients in each of the three regions and in total for each of the last six half years. There is a dip in the number of active clients in the second half of last year compared with the first half, and that reflects a drop in the UK due to the number of new clients who first traded around the UK's EU Referendum who did not continue to trade into the second half. The number of active clients in the UK in the second half of last year was still higher than in any other half year period except for the first half.

The important message from all of this is that the growth in our revenue has been driven by growth in the number of active clients and by the revenue from new clients who trade for the first time in any period. And later in the presentation Peter is going to take you through the actions we are taking with respect to client on-boarding and how we expect these metrics to evolve.

The summary of our operating expenses is shown on slide 8. More than half of the £35m increase in operating expenses is due to the higher investment in external advertising and marketing, and the incremental costs in the year as a result of the purchase of DailyFX. Around half of that £4.4m is reflected in the amortisation charge, with the other half in fixed remuneration. Excluding external advertising and marketing and DailyFX, operating expenses are up 8%, in line with the increase in revenue.

The charge for variable remuneration was lower than in the prior year if we came in under some of our internal targets. We do hope to avoid repeating that, and I would guide you to include a charge for variable rem for FY18 closer to the charge for FY16.

We've also benefitted from a £3.4m reduction in regulatory fees year-on-year, which reflects a rebate of FSCS levy paid for prior years and an adjustment to the accrual. We expect the charge to be at a normal level for FY18.

Now some of the increases in our costs are driven by client activity and revenue and others have increased due to our choice to invest, for example, to make sure we continue to offer excellent customer service, to deliver new products and services and to expand our geographic footprint. We're going to continue to invest both tactically, for example, by removing charges for clients using payment cards or PayPal to deposit money with us, which will add around £3m to costs next year. And strategically to further differentiate ourselves through our product offering, and through further expansion of our geographic footprint.

We have however taken actions to reduce costs by around £15m across the business so that we can make these investments without significantly increasing the fixed cost base. As a result, and as set out in the outlook statement in the announcement, we are giving guidance that we expect operating expenses in FY18, excluding variable remuneration, to be at a similar level to FY17.

Moving on from income and costs, I want to take you briefly through cash capital and liquidity. We use own funds and net own funds generated from operations as our key measures of our cash generation. Our business is highly cash generative, we receive cash from our profit the next day. Our own funds generated in the year are higher than our operating profit, which reflects the non-cash charges in the P&L. Our working capital is a net payable, and the movement in the working capital balance is largely driven by changes in the level of the short-term bonus accrual. After tax we generated net own funds from operations of £183.9m, and the right hand side of the slide shows how we've used those funds that we've generated both for capital investments, which in FY17 include the purchase of the assets of DailyFX, as well as the investment in our modern office project in London, the new web trading platform and new financial systems, and for dividends. We paid the £84m final dividend for FY16 during the first half, and we paid the £35m interim dividend for FY17 in the second half. Our own funds' balance at the end of the year, including the benefit from the retranslation into sterling of own funds in non-UK entities, is £614.3m.

The balance sheet on slide 10 shows that the Group is in a strong financial position. Our total net assets have increased by £72m compared with a year ago, which primarily reflects the profit we've retained in FY17 plus the effect of the weakening of sterling on the value of our non-UK entities net assets. That increase in net assets is reflected in the £27m increase in own funds, and a £36m increase in fixed assets due to the capital investments that we made in FY17.

Now one of the key balance sheet lines we manage is liquid assets. This comprises our own funds plus client funds which are not segregated. These are the amounts that clients have deposited with us at our Swiss bank, or have transferred to us via a title transfer arrangement. We do not currently use any of the Swiss bank deposits for liquidity purposes, and all of our clients' deposits in Switzerland are retained within that entity and held in bank accounts in that country.

On the right hand side we show our analysis of available liquidity, one of the key measures for us internally. Our available liquidity is equal to the total liquid assets per the balance sheet, less the amounts within that balance that are being deployed as broker margin requirement, are being held in non-UK entities or are held within client money. And the available liquidity at any point in time is largely driven by the level of broker margin and to ensure that we will have enough liquidity to meet our potential requirements we have access to a committed revolving credit facility of £160m.

We did draw down on the RCF at times during the year to ensure we had sufficient available liquidity on hand to deal with potentially increased broker margin requirements. These drawdowns are precautionary and in practice we’ve never needed the cash, but the RCF is an important liquidity risk management tool particularly as you can see on the chart on the right hand side of page 11 the level of broker margin has continued to rise. The average level of broker margin requirement in FY17 was £286m, more than £70m higher than in the preceding 12 months. More importantly for the purposes of liquidity management the peak requirement reached £367m during the year.

Now the increase in margin requirements is not surprising, the margin we need is driven by the size of our notional hedging positions which in turn is driven by the size of our clients’ notional positions and the extent to which we can internalise. Now the chart on the left hand size shows our clients’ notional positions at the top and our hedging notional positions at the end of each month over the last two years. And the difference between the clients’ positions and our hedging positions represents the extent of our internalisation of client flow.

The flat line at the bottom shows the notional size of the residual market positions we held after hedging. And these residual market positions are really small. We internalise or hedge more than 99% of our clients’ positions and our trading revenue is therefore driven by clients’ transaction fees net of the cost of hedging. We do not benefit from client losses, on the contrary we prefer clients to make money from their trading as they are then more likely to keep on trading. Peter over to you.

Peter Hetherington, CEO

Thank you very much. I'm now going to briefly review how IG performed against some key metrics last year before looking ahead to Financial Year 18 and the changing regulatory landscape in quite a lot more detail.

Looking at the year we title it a good year in dull markets which pretty much summed it up. If you look at the two graphs on the left the top one shows you the long-term volatility index, the VIX, averaging 19.5% over the long run since 1990. The bottom on the left shows you the last three years and you can see the year just finished was the lowest of all with volatility index averaging 13.3%. If you look at the numbers for April and May, as most of you know, they were the lowest numbers ever recorded for the volatility index.

Despite this IG performed well and grew revenue across the board. As you can see on the graph on the right the majority of the growth is coming from newer and developing markets, primarily Switzerland, Dubai and South Africa.

I'll now focus on looking at the core OTC leveraged business. You've seen these graphs before so I won't spend long on them. Markets were subdued and we reduced marketing spend as you can see in the second half of FY17.

As we told you we would we will continue to flex marketing depending on market volatility and client demand and we intend to continue doing this.

Despite this the number of first trades has increased by 34% over the year, which is good, and despite the increase in applications we've managed to maintain our conversion levels, getting clients from applied through to open and handled an additional 54,000 applications in the year just gone.

Looking at this slide again, you've all seen this before, we thought it was useful to bring it up again, Paul mentioned clients recruited over Brexit have stopped trading to a greater degree than normal cohorts of clients have stopped trading. You can see the purple line which stops after 12 months shows clients recruited over the whole year; the dotted line shows you clients who have been recruited since July, so after Brexit. It seems very clear we recruited lots of clients over Brexit who wanted to trade that singular event and therefore stopped trading in greater numbers once that event had passed.

Looking at the graph on the right, I'd focus you in on the bottom left hand corner of the graph, this is something we use internally quite a lot and as you know we target recruiting accounts with a payback of £1,200 and we expect clients to pay back the cost of their acquisition within four months. And here you can see the cumulative average client value line and it shows very clearly that the clients we are recruiting, on all these cohorts of all these different years, all pay back the cost of their acquisition within the four months that we're targeting.

You can also see the same Brexit effect on the purple line and the dotted line, the clients recruited post-Brexit are fractionally higher value, we don't consider that statistically significant.

This slide's quite important. If you look at the bar on the left you can see how long our clients have been trading with us and fully 51% of revenue is generated from clients who have been trading with us for more than three years. We believe this is a very different stat to most of our competitors.

The chart on the right, we've talked about before but we've never given this much detail and it shows our client concentration. Our top 2% of clients represent half of our revenue. The next 7% represent another 30%. So what we can say is 80% of revenue comes from our most valuable sub 9% of clients. Or if you prefer it the other way round, roughly 90% of our clients only account for 20% of our overall revenue. This reflects a journey we have been on for many years better serving our most valuable clients.

If you look just at the top 2% of clients, the average tenure, how long these people have been trading with us, is greater still than the average we gave you before – it's well over five years that the top 2% have been trading with IG. Two clients have been trading with us in the top 2% for 34 years.

Please remember this slide, I'm going to come back to it later in the presentation as it is quite important.

Our unleveraged business continues to perform quite well. We now have 20,000 active clients with this product and feel we're making good progress in the UK and Australia with it. Our initial belief was that our non-leveraged offering would encourage clients to trade more and trade with us both on leveraged accounts and non-leveraged accounts and we're pleased to report this seems to have been proven correct. We're also pleased that we've managed to launch our smart portfolio offering which allows clients to access model portfolios constructed with ETFs in a passive way.

Smart portfolios, the ETF product, offer a number of advantages including transparent charging structure. This aligns with FCA's recent comments about the asset management industry and we're pleased we chose to go with total cost of ownership model as our selling point for that product.

Looking at NADEX, again quite briefly, continues to perform strongly across all metrics. This period has seen good growth in client numbers at a relatively low cost. You can see on the graph on the right how many first trades we're getting and the cost per first trade, the same graphs we showed you for the main leverage business they're just for NADEX.

We're pleased we stuck with NADEX through some pretty tough times some years back and now feel we have a really useful asset and expertise which will serve us really well in the future with where we're trying to go in Europe.

Looking at the platform and developments in it, we've rolled out our next generation platform to all spread betting clients and now over half of all spread betting web-based trades are placed on the new platform. We'll expand the roll out to CFD clients in the near term but will not be force migrating any clients for the foreseeable future.

Our next generation platform integrates well with the look and feel of My IG, which I showed you last time. As we've mentioned before My IG provides clients with tools to manage all their accounts and access news and educational content such as DailyFX. DailyFX is an increasingly important tool, especially as it allows us to continue to reach clients in the event that advertising restrictions come into force.

Looking at our vision and values, we've been in business for over 40 years now and as a company have never been fined or sanctioned by any regulator worldwide. This reflects our culture and values. We've recently rearticulated these values for both our employees and for external stakeholders and you can see them on the boards around you in this room. There's also an interactive corporate timeline on the Group's site that some of you might find interesting.

What are our values? Firstly we believe in championing the client, doing the right thing even when it's not a regulatory requirement. Secondly, we believe in leading the way, challenging the status quo and setting standards for the industry. Finally, we love what we do, we work as a team to achieve what really matters.

I firmly believe these values sum up our strong compliant culture which is key to generating long-term value for shareholders. And I want to offer some practical examples of these values in action.

Limited risk accounts. Firstly let me explain what a limited risk account is. Put simply it's an account where a client must open each position with a guaranteed stop attached and the money required for that position already on their account. This means there's no possibility of clients losing more than the difference between the opening price and the stop i.e. fixed and known amount of money. The client would also be charged a premium if, and only if, their stop is triggered. If you close the trade yourself no charge is levied. We're unique in offering the product in this way. To give you some context only a quarter of guaranteed stops are actually triggered.

Why are we doing this? We believe it's the right thing to do because we believe it's the right product for the lower end of the client base. We think we're a company that learns from our experiences and following the Swiss Franc de-peg we reviewed how we could better serve clients. That review led to us redesigning and relaunching limited risk accounts, regulators in Europe have subsequently followed a similar approach and we've seen that both in France and Germany.

All clients can choose to trade with limited risk positions if they wish but clients with lower appropriateness and wealth can only trade using limited risk products.

We believe this product is the right product for the less experienced or wealthy end of our client base as it removes the possibility of unquantifiable losses. The proportion of clients trading on limited risk, as you can see on the chart, is increasing and we expect around half of our clients to receive a limited risk account over time. This will be higher in Europe as BaFin for example have mandated no negative account for all clients.

What else are we doing? Looking at appropriateness, I think you just have to say look why are we doing this? We're doing it because we believe it's the right thing, it's a project we started near a year ago. We require clients to take an appropriate assessment during their on-boarding process and we ask clients to show an understanding of CFDs and the risk associated with them by either having previous sufficient prior trading experience or by demonstrating knowledge by answering a series of questions. Clients must score at least 80% on the knowledge test to pass.

On the next slide there's an example question. I'm not going to give you all time to do it but it'll be in the deck if you want to come back to it later.

Looking at ESMA, the European regulatory umbrella, they've recently issued guidance via its Q&As and the FCA also recently commented on appropriates noting that firms should strengthen their process. However existing regulations do allow firms to accept clients for whom they deem the product inappropriate if they acknowledge a risk warning or two. We don’t think that's the right thing to do and do not do that. We’ve exceeded those requirements and the ESMA guidance and will not on board clients who fail the appropriate test.

This is something as we said we commenced building well in advance of the FCA’s consultation paper and reflects both our values and expectation on the future direction of travel. We believe this will result in better client outcomes although it will reduce client numbers in the short term. This is part of our focus on quality over quantity.

In the medium term we expect to develop a smaller, albeit more valuable, client base who remain with us for longer.

Then there's the question, I won't give you time to do it but you can come back to it later if you like. Hopefully most of you would pass! We might do a test at the end.

Looking at wealth and partners, we’ve long had wealth bars for many years where we’ve said, “If you don’t have sufficient wealth, either earnings or savings, we will not on board you as a client.” We've recently been reviewing them and have been upping what the wealth bars are for who we will on board.

To give you some context, for a potential client without savings we’ll refuse all applications for anyone with a salary below £50,000 and we’ll only give a full leveraged account to those earning over £100,000. Obviously they also need to pass appropriateness and all the other usual onboarding requirements as well. At the same time we’re increasing our minimum deposit size. This will result in us reducing the number of clients we accept, especially from the leisure end of the market.

We’re also reviewing all our partnerships and we said we’ll only partner with companies that clearly share our values. As a result we’ve terminated the majority of the relationships we had. This is another example of us getting ahead of where we sense the direction of travel is going.

I promised to spend some time on the regulatory landscape, so forgive me for slowing down a little bit through this section. I want to start with a global overview. As all of you know, all of our regulators are members of IOSCO, the International Organisation of Securities Commissions, who issue relatively high level guidance. Outside of EMEA we have changing leverage limits in Singapore, which we’ve told you about before, and updated client money rules in Australia which we fully support and have lobbied for. Within EMEA, for Dubai we’re still expecting some regulatory action in due course, however the overwhelming majority of current regulatory action is taking place within the EU which is under the ESMA umbrella. To a large degree this represents Europe catching up with the rest of the world.

ESMA itself has recently issued a statement on potential future product intervention powers and we’re actively engaging with them and supplying data to them to allow them to come to an informed decision. We’ve also seen a number of consultations and measures from EU regulators, including France and Germany, introducing no negative accounts and various other limitations on marketing, all of which seem proportionate and sensible. It’s also very clear there’s a significant range of views from different NCAs, National Competent Authorities, about what the right answer to regulating these products is.

Regulation is changing. As discussed, EU regulation is changing and I want to note that we support ESMA’s efforts to harmonise regulation and remove the opportunity for regulatory arbitrage. In our little bit of the FS world the single market for these products has almost completely collapsed and we would very much welcome it reforming.

There are five main themes to the ESMA work which they've published. I've already discussed appropriateness and no negative protection, obviously we're delighted by the direction of travel here. On the third one, we do not offer bonus offers within Europe. We do know they can be very, very effective, and we do know that a number of the larger firms in the industry do recruit sometimes more than half of their clients through the use of bonus offers. We don't think it's the right way to go and don't think it brings in clients who'll be the right type of clients for us in the long term.

Ditto, mass market advertising. If any of you watch football on TV you can't have missed the advertising for CFD or FX firms at every single game. We simply don't think that anyone should be advertising complex derivatives which have high levels of leverage to a mass market audience. We do still sponsor Harlequins, the rugby union club, as most of you know, but we only do that for our share dealing and robo-advice smart portfolio offering.

Finally, I wanted to discuss our thinking on leverage in more detail. It's a complex subject, and I'm afraid you've got four more slides to go on leverage. Specifically I want to cover why extreme leverage is damaging, then I want to cover the potential impact of disproportionate leverage limits, and then I want to going to what clients could do if faced with disproportionate leverage limits, and then I want to go into what IG could do if faced with disproportionate leverage limits. So bear with me here, this next one is a tough slide and I'm going to go quite slowly.

If you only take away three things from this slide please take away extreme leverage is definitely damaging. Secondly, IG only offers appropriate leverage. And thirdly, the FCA's now stayed leverage proposals went way beyond the levels needed to improve consumer outcomes and would likely have forced clients to seek the leverage they clearly desire from offshore providers.

A recent independent survey showed that we shouldn't underestimate how much clients value leverage. They found that 60% of clients trade CFDs or spread bet because of the leverage offered. 46% of them said they don't consider where a firm is regulated or would choose an offshore provider if they offered features they liked, such as more leverage.

Now let's discuss the graph and show you why extreme leverage is damaging. We all know all trading is a zero sum game. In the absence of transaction fees the probability of success on any individual trade is exactly 50%, absent transaction fees. We also know transaction fees reduce that percentage. The transaction fee is the spread or commission that the broker charges. The greater the fee relative to the deposit required to do the trade the more impact this has. Different transaction fees apply to different products, so the right level of leverage is different by asset class and product.

If you look at the graph, the red box on the left shows where deposits are a similar magnitude to the transaction fee, and the loss of the deposit becomes inevitable. If you have £100 deposited and open a position where the transaction fee is £100 you will instantly be closed out and guaranteed to lose on that transaction. On the graph here you're at the point where your ratio is one and you're 100% likely to lose on the trade. We give a couple of examples there. Just this morning I saw an advert a firm was putting out offering 2,000:1 leverage on currency pairs. You're right at the far left hand end here where you're almost guaranteed to be closed out instantly if that's all the money you have on your account. So key takeaway one, extreme leverage is definitely damaging because you materially change the chances of winning or losing on any individual trade.

Now let's look at the green box. This is where we have all our products, and as you can see, we do not offer any products where the percentage chance of winning relative to the deposit is materially skewed by the transaction fees. We constantly review our leverage that we offer to make sure that our products stay in the safe zone.

The purple box, and you'll note the wavy line which denotes the break in the scale on the bottom, shows the FCA's proposed leverage limits which they suggested back in December 2016. As you can see, these are significantly below the point required for good client outcomes and ran the risk of driving consumers to unconstrained providers.

We do think that by implementing proportionate leverage restrictions NCAs can minimise poor client outcomes resulting from extreme leverage and from clients accessing potentially unregulated offshore providers. The fact that ESMA is now talking about this is helpful because it reduces one of the two potential sources for regulatory arbitrage, that of passported in firms.

So let's imagine now that onerous leverage restrictions are in fact brought into play, okay? What would happen and what would our clients do? And also please remember before we start this that of the revenue under scrutiny a significant proportion is clearly unaffected, as it comes from people who are outside the EU, but trading with one of our EU branches, or are from corporate accounts or is generated from equities which we already offer on a low leverage basis. So the question we're trying to answer is how might in scope clients respond to onerous leverage restrictions?

I'll remind you of slide 16, which I said I would: Less than 9% of clients generate over 80% of our revenue. There is a regulatory differentiation between retail and professional clients, which has been around since MiFID came into force. Professional clients have not been impacted by any of the current European proposal and we believe that's likely to continue. Historically we have not classified any individuals as professional. Should there be disproportionate restrictions on retail clients it means clients are much more likely to want to be classified as professional as there'll be a clear benefit for them in doing so.

To be classified as an elective professional a client must meet any two of the following three criteria. Have conducted an average of ten trades per quarter over the last four quarters on relevant instruments in significant size as defined by the firm. Have a financial investment portfolio, excluding your primary residence, greater than half a million pounds, note the pounds. Work or have worked for at least a year in a professional capacity which requires knowledge of derivatives at some point in their life, not necessarily currently.

Then looking at how our clients fit into that. The criteria for the number of trades is met by virtually all of our largest clients. The top 9% of clients open trades on average around 1,500 times per year each. Very few of them do not open 40 trades a year. The significant size and per quarter part is interesting, but our analysis suggests that the majority of these clients do indeed qualify on this test using just the data we hold for them ourselves. Obviously were it to become important it would be reasonable to expect clients to modify their behaviour by consolidating trades or by supplying data from other brokers as well, if they perceived an advantage in so doing.

The graph on the right hand side shows the investment trends data from a recent survey literally of a couple of weeks ago. And what you can see here on the left hand side of it is the IG responses and on the right hand side you can see responses from all other firms, excluding IG. As you can see, a minimum of 15% and probably more if you add in the won't says and those who straddle the bars, so the euros and pounds bar, euros for the portfolio side, pounds for the bars here, so the 250 to 500, some of them will obviously qualify. However, this is an independent survey, you can see the number of responses, 733 IG clients, 811 for the whole of the rest of the industry, we haven't matched them up to our biggest clients, so it isn't necessarily true that the richest clients are our most valuable, but valuable clients do tend to be wealthy.

As you can see, these numbers are materially higher than our competitors and they underline the journey we've been on for a number of years as we focus on serving the premium segment of the spread betting CFD markets. It's important to note that if a client wants to be professional it's up to them to ask, it's not for us to tell them.

On the final criteria, current or previous experience in financial services, people generally overestimate the proportion of our client base they think will be currently working in financial services but we just don't know, and as the requirement is ever rather than currently, data we hold on clients isn't particularly useful for working it out, so we're not suggesting any percentage there, and we'll let you form your own opinions.

Now let's look at what clients who can't or don't want to be classed as professional might do if onerous leverage restrictions are brought into play. The first thing they could do is they could manage their account with less headroom, and for the first time here I think we're explaining that clients tend to carry a lot of excess cash on their account. If you look at the graph on the right hand side you can see very clearly that the amount of money people have got is the line on top, that's the amount of money they've deposited with us, and then the two lines at the bottom show you their margin requirements at any one point in time.

We've also broken it out into equities where we currently don't offer much leverage anyway, and the rest. And the rest is important because it is the smaller part of that line and that's the bit which might change. And so what we're saying there is clients have quite a lot of spare cash in aggregate, not necessarily individually, on their accounts.

Paul, Kieran and I in every meeting are asked what leverage our clients currently employ. It occurred to us in doing this presentation that we were actually giving you the number because you can see the client deposits, and on Paul's last slide he showed you the gross client positions, and most of you can divide one by the other. We've gone a little bit further and we've excluded all the cash from people who don't have any open positions at all and looking at the people who have open positions and the cash on their accounts the average leverage used by clients is less than ten for one. However, it's an average, I don't much like the number, I don't much like the stat, and I would caution you against using it because averages in financial services can, as you all well know, be misleading.

So I think what we're saying is clients who choose not to be professional or can't be professional can simply manage their accounts with less headroom and they have plenty of headroom. The second thing they could do is they could increase the deposit they have on their accounts. And the investment trends data suggest that the people had a small amount of their wealth with us and therefore we are preparing for the day when we have significantly more of our clients' money to look after for them.

The next thing they could do is they could utilise a share portfolio as collateral, which is the USP of IG. And of the half billion pounds of AUA that we have on unleveraged accounts about £60m is currently linked to be used as collateral on leveraged accounts. Rationally you would expect that to increase if there was a benefit in doing so.

The next thing they could do, which is the one you're all worried about, is they could constrain their trading, which obviously would impact our revenue. And the final thing they could do, which would also worry you, is they could seek a less constrained provider. But obviously the harmonised approach across the EU reduces the possibility of this but does not remove it.

Then I said we would talk about what IG could do if owners' leverage limits were brought into force. We're adapting our business to better meet the challenge we face by focusing on four strategic themes: we're developing a European MTF, a multilateral trading facility, to better meet consumer and regulatory preferences for increased transparency. An MTF is a trading venue, essentially a non-discretionary matching engine bringing together market makers and clients. This means many third parties could connect to our MTF. We already run Nadex, have done for ten years, it's located in the US and regulated by the CFTC and it is both a clearing house and an exchange. We can utilise our experience in technology from Nadex when developing our new EU based MTF.

However, significant challenges remain before we could launch such an offering, and it's not clear at this stage to what extent the currently proposed product intervention measures would impact products listed on an MTF. Nor is it certain that we'll get regulatory approval and indeed launch the MTF.

What else are we doing? We're continuing to expand our non-leveraged offering which allows clients to develop a longer-term relationship with us and allows us to continue to advertise, even if French style advertising restrictions are introduced.

We're also assessing our geographic footprint and are considering new opportunities outside of Europe.

Finally, we're enhancing our content and natural search capabilities to improve our organic online presence, which will help mitigate the impact of advertising restrictions, as will DailyFX. All of these measures allow us to continue to attract clients, including a subset who may be eligible to become professional clients.

By way of conclusion, as you have seen the business has performed well over the last year, especially given the quiet markets. This reflects the quality of our employees, our compliant culture and our strong acquisition capabilities. We will continue to do the right thing by championing the client and leading the way, especially in regulatory compliance. We will also continue to develop opportunities for geographic and product expansion.

We think regulatory change is inevitable. We support proportionate measures which lead to good client outcomes and welcome harmonised regulation in Europe.

As discussed clients value leverage, even if they don't always employ it, and therefore we believe it's important to set appropriate leverage limits that avoid poor client outcomes, but don't force clients to offshore providers.

We've noted the number of potential measures clients in IG can employ in the event of disproportionate leverage restrictions, such as clients requesting to be classified as professionals, or if they can't be reclassified amending their trading behaviour.

We are implementing a number of initiatives to future proof our business. This includes focusing on client quality over quantity and investing for the future, which as Paul outlined will be funded by finding savings in other sections of the business.

I believe IG is very well placed to adapt and to benefit from regulatory change and we'd be delighted to answer any questions you may have. Thank you for your time.

Q&A session

Question 1

Paul McGinnis, Shore Capital

First of all could I compliment you on how comprehensive that was, particularly with respect to the regulation; that was much welcome certainly from our side.

With respect to the European harmonisation do you think the fact that the FCA has now delayed to wait to see what ESMA does, do you take that as a sign that it's less likely that they would subsequently gold-plate anything that came out of ESMA?

Peter Hetherington

We truthfully don't know. We're not the FCA. I think if you look at the statements I think the FCA is influential at ESMA in helping to set the policy, I think that's clearly true for now. I think also the FCA said that they were not going to be coming out with proposals unless they didn't think ESMA went far enough, in which case they might choose to go further. I think you've seen the same as I have and I've got nothing more to add on that.

Paul McGinnis

Second one just in terms of the year-end broker margin requirement which is obviously up quite substantially on the previous year, much more so than the revenue, is that a function of clients holding positions longer or is it something else that we should be aware of?

Paul Mainwaring

It isn't a consequence of clients holding positions longer; it's a consequence of both the size of the notional positions and the extent to which we can internalise. So if clients are all the same way, they're all short indices and long individual equities, you can't internalise as much. We're in a position where the markets are reaching all-time highs, where the FX has gone against us, so the notional value of anything that's in non-sterling is greater in sterling equivalent. And where clients have been increasingly not offsetting we can internalise less. That's what has driven that.

Peter Hetherington

I think a lot of it is a function of where the equity markets are. And when equity markets are very strong clients tend to want to go short of them and they tend to be want to be quite mono-directional as a group and therefore with equity markets breaking new highs that is what you would generally expect.

Question 2

Hayley Tam, Citigroup

At slides 22 and 24 you've been very clear with us that these voluntary measures to improve appropriateness testing and wealth measures are going to perhaps reduce the growth in the number of active clients whilst you would expect the revenue per client to go up. Are you willing to give us any statements about timeline or overall revenue impact?

Peter Hetherington

No. We have put these measures in place and they are all live, but we haven't got enough data to say with confidence what they mean. I would take you back to slide 16 though and say where do our valuable clients come from and our intention very much is to not on board clients who will not be valuable to us but to continue to on board all of the valuable accounts. How successful we are in that endeavour only time will tell.

Hayley Tam

Thank you. And then the second question just in terms of cost guidance excluding variable remuneration that you've given, I think I understand what you're saying is you'll be cutting some fixed costs this year to help fund your continuing investment. How should I think about your marketing costs within that framework?

Paul Mainwaring

It's a good question. We will continue to seek to attract new clients so long as the cost per first trade remains economic. We are assuming, per your first point, that if we're going to be recruiting fewer new clients then the marketing spend could likely come down a little to what we spent last year, so there is an element that we're assuming that we'll manage the marketing spend in FY18, it's part of the saving but it's not a significant part of it.

Peter Hetherington

We'll manage it to demand, very clearly. And I think if you look at Paul's bridge on one of the earlier slides you've got the number for how much we spent on marketing last year, £64.5m, and you've got the revenue we got from clients recruited last year themselves in their first year which was £80m something.

Paul Mainwaring

£87m.

Peter Hetherington

So you can see that. All we're saying is we target to this graph, we target £1,200 as a cost to bring in a trading client. If clients are suddenly getting more valuable, so long as they're paying back the cost of their acquisition in sub four months that's what we'll aim for. So, we're aiming for the sub four-month payback rather than the £1,200 because we're expecting the mix to change if you bring in fewer better clients.

<u>Question 3</u>

Laurence Endersen, Capstrive Ltd

Just a question back on slide 16 on your client mix. Just the 2% or indeed the 9% how are they different from the Group at large in terms of maybe how much leverage they would use, their churn or other distinguishing features, particularly the 2%?

Peter Hetherington

We've already said they churn less. The average tenure of the top 2% is well over five years, plays three years for that overall. So, that gives you one data point there.

In terms of leverage I think I know but I'm not certain so I'm not going to say.

Laurence Enderson

Okay, perhaps a follow on question. Just on the overall market in terms of market share dynamics and market growth and barriers to entry is the market getting easier or harder for you?

Peter Hetherington

The market is fragmented there are lots and lots of providers in the industry. I think you've got lots of lessons from history about what has happened as different parts of the world have cracked down on bad behaviour by some providers. And I'd give you the US as an example: if you go back five years there were 40 something FDMs or RFEDs or Forex dealer merchants in the US; there are now three. Each of those is considerably bigger than they were five years ago, the overall market has shrunk, but the survivors have all grown significantly.

So I think the expectation, it does rather depend where ESMA goes, but if you look at the US experience they cracked down really hard on people who didn't comply with the rules, they brought in pretty high capital requirements to make sure that only big firms could play, and they brought in advertising and leverage restrictions which prevented the people who recruited clients from bonus offers and so forth from being able to partake of the market.

So I think in order to answer that you need to decide how like the US, Japan, Singapore et al the ESMA crackdown is. And the more it's like the ones we've seen in history the more confident I am about our place in the market going forward.

<u>**Question 4**</u>

Jonathan Gosling, Numis

If you're looking at the top 9% of clients it works out the average revenue per client is around £30,000, thereabouts roughly speaking.

Peter Hetherington

Do it for the 2%.

Jonathan Gosling

Even higher. My question would be more with the proposed regulatory changes coming through and the demise of the smaller brokers. Are there any £30,000 clients fishing around with the net market and how many do you actually realistically expect you could pick up from them?

Peter Hetherington

There clearly are some. Different brokers fish in different ponds, and some unashamedly fish in a leisure type market – and I don't think you'll get many very valuable type clients in a leisure type market. Others fish in a sort of 'follow my friend' copy trading type market – and again I'm not sure there will be that many. But I think it is fair to say if people want to trade they're going to trade.

There are hundreds and hundreds of brokers out there genuinely. I think there are 97 regulated brokers from the FCA and there are 220 something passported into the UK from outside of the UK but from the rest of the EU. So you've got over 300 firms; there will be a significant number of valuable accounts at many of those places. Although I do think given our history and scale we disproportionately have a number of them.

Question 5

Alistair Ross, Investec

Peter, just in terms of the graph on the right, one, binary options of the 80% can you give that split in terms of how much of the binary option's 9% falls into the 80%?

Peter Hetherington

Sorry no, don't know. It's not that I won't tell you, I genuinely don't know.

Alistair Ross

And then the 80% can you give us some sort of an indication of the geo split, given that ARPU is high in the UK, do you know just roughly of the 80%?

Peter Hetherington

I do. We are overweight UK valuable clients. We've been attracting clients in the UK for 40 something years. Two of the top 2% have been with us for 34 years. We've only had a European business for ten years. Therefore you have to say, given that we are overweight UK clients, definitely. You can see it in our numbers, you can see it in the geographic split. I would expect that same thing to play through in that stat you see there.

Alistair Ross

But would it be more overweight UK? I'm sort of expecting, so if you say 45% of your revenue is UK, of that some of it is binaries, of the ex-binaries you split that into that sort of a graph, so in other words you're just taking UK revenue now, the 80% is going to be even more I expect.

Peter Hetherington

Kieran is going to answer this. I'm not sure I'm going to get the right answer.

Kieran McKinney

No, my answer is. It looks quite similar.

Alistair Ross

It looks exactly the same.

Kieran McKinney

If you take the 2% for example: the 2% in the UK is about 1.6 and in other countries it's sort of 2 or 2 point something. So it's a little bit of movement between there but it's quite minimal.

Alistair Ross

So we can sort of assume that in the UK 80% is roughly I guess…

Peter Hetherington

9%.

<u>Question 6</u>

Richard Taylor, Barclays

Can you give some insights on how the Board thinks about dividends? Under the assumption that regulation might hit earnings, you've shown in the past a willingness to flex the payout ratio when earnings fall. Is there a ceiling on the payout ratio that you have in mind or is it a duration of earnings to client under that assumption?

Peter Hetherington

We've got our Chairman Andy Green here so if he doesn't like the answer I hope he jumps in.

As you saw with the events around the Swiss franc de-peg earnings did go backwards, we did maintain the dividend. We say we have a progressive dividend policy: we aim to maintain the dividend even if earnings go backwards up to the point where we actually need the money. And I think that is our position. I think that has always been our position.

Our intention would be, there's no guarantee that they do go backwards, but if earnings do go backwards our intention would be to maintain the dividend until it was impossible so to do.

Is that fair Andy?

Andy Green

"We always have to ensure the business has enough cash for the future", for investment and to deal with unforeseen events. Whilst it is never possible to give an absolute commitment on future dividends, the Board has put in place a progressive dividend policy. Included in this is an intention to maintain the dividend where there is a temporary fall in earnings, as we did after the FY15 year. This would of course be a judgement which could only be carried out at the time, considering all of the factors impacting performance and the requirements for cash at the time.

Alistair Ross, Investec

Sorry Peter, just on that comment, when you say impossible to do so what type of headroom are you talking about?

Andy Green

“You have to know the circumstances that are driving the reduction in earnings before you can come to a conclusion on what you think about the future.” As I said already, you would have to consider all of the factors impacting performance and the requirements for cash at the time.

Peter Hetherington

Any more? Thank you all very much for your time.