IG Group plc

FY18 Preliminary Results Presentation

Tuesday 24 July 2018

Peter Hetherington, Chief Executive Officer

Welcome to IG's full year presentation for the year ending for the year ending 31 May 2018. I'm Peter Hetherington, Chief Exec. Looking at the agenda today, today's presentation breaks down as follows. A very brief intro from me. Paul's then going to take you through the financial results of the Group. I'll then do a re-cap on our competitive advantage, an update on regulation and what's happening with mitigation plans, and finally, we'll look at the future growth story. I'll just give you the obligatory disclaimer which we'll quickly get through and then go into it.

We had a record first half, we had an even stronger second half, and therefore have achieved record revenue and earnings for the year, as you can all see on this slide. I'm particularly pleased we delivered the cost guidance we gave you at the beginning of the year. This should hopefully give you all some confidence in what we have to say today.

Basic earnings per share for the year were 61.7p, 34% higher than the prior year. The Board is recommending a final dividend of 33.5p per share, taking the full year dividend to 43.2p per share, 34% higher than FY17's dividend, and in line with the previously stated intention to pay out around 70% of earnings.

Before I hand over to Paul, let's just have a quick recap on purpose, vision and values. For those of you that know me, you'll know how much I believe in this slide. It's what sets us apart. We provide clients access to financial markets for our product that's risky, complex and somewhat difficult to understand. We all know what we're offering and we do it incredibly responsibly. We care about our clients, they're at the centre of our values. To summarise, our vision and values are simple, they fit with the culture of the people at IG, they're authentic, and they're what defines us.

Paul, over to you.

Paul Mainwaring, Chief Financial Officer

Thank you, Peter. Good morning everyone. I'm going to take you through our financial performance in FY18, and then our financial position at the end of the year.

FY18 was, in financial performance terms, an excellent year. Our net trading revenue was up 16%, which drives the 17% increase in net operating income. Operating expenses and variable remuneration both in line with our previous guidance, and operating profit in FY18 was up by 32% to £281.1m, with the operating profit margin increasing by 5.9 percentage points to 49.4%. The effective rate of tax for FY18 is 19.4%, in line with the guidance we gave on 23 May. The 1.4 percentage point reduction in the rate from the previous year largely reflects the reduction in the rate of UK Corporation Tax. We estimate that the effective rate of tax for FY19 will remain at around 19.5%. Basic earnings per share of 61.7p, are 34% higher, in line with the increase in earnings, and as Peter has said, we will pay a dividend of 43.2p per share for the year.

This next slide shows you more detail on the 16% increase in net trading revenue. OTC leveraged revenue was up 16% at £548.4m, with good growth in each of the three regions. Our clients trade in markets where there are opportunities, and the breakdown of the OTC leveraged revenue by asset class shows that, compared with the prior year, in FY18 there are more interesting opportunities in FX, which includes our cryptocurrency products, and relatively fewer opportunities in commodities.

Our revenue from crypto products totalled £36m in FY18, just less than 7% of our OTC leveraged revenue, and as only £10m of that came from new clients, the vast majority of our crypto product revenue came from existing clients. Now client trading in crypto products has slowed markedly since the end of January, and we are looking forward to seeing which markets clients find interesting opportunities in this year.

All of our revenue in the USA comes from exchange traded derivatives, and revenue from Nadex was up 18%. In our share dealing and investments' business, whilst the absolute amount of revenue from these products is still small at £4m, these products do provide an important aspect to our relationship with clients.

Looking at client trends, the 144,600 active OTC clients was 2% lower than in the prior year, which was driven by the reduction in the UK, which as we have explained before reflects the boost in client recruitment and active clients in the first half of the prior year.

In the second half of FY18 the number of active OTC clients was 1% higher than in the prior year. OTC leveraged revenue per client has been strong throughout the year and increased by 18% to just under £3,800. Our revenue per client reflects client income from spread to commission and funding, which was primarily driven by the total volume of client trading, and by our hedging efficiency which determines the extent to which we convert client income into trading revenue. Both client trading volume and hedging efficiency were consistently strong throughout the year.

At Nadex, the 1% reduction in active clients was more than offset by the 20% in revenue per client. And in shared dealing and investments we achieved a 74% increase in the number of clients holding assets with us at the end of the year to over 35,000, nearly 20% of whom also trade leveraged derivatives with us.

We continue to believe that increasing the number of multi-product clients will have a significant longer-term benefit as our data show that these clients have a lower attrition rate and are more valuable than single product clients.

This next slide shows you the bridge for OTC leveraged revenue from FY16 through to FY18. The revenue from new clients in FY18, at £82m, was very close to the new client revenue in the prior year, and more than offsets the impact of clients not trading in the year, net of those returning to trade, as it did in FY17. The key difference in FY18 and therefore the driver of the increase in the rate of growth of revenue, is that existing clients traded more in FY18 than they had in the prior year, whereas in FY17 existing clients traded less.

We seek to target sophisticated traders, and we expect that new clients we recruited in FY18 will follow the normal attrition pattern and that they will continue to generate revenue for many years. And that is because one of the key features of this business is the long tenure of our clients. The chart on the left shows the cumulative average OTC leveraged client value for the five most recent years' client cohorts, which continue to show a very similar pattern. The chart at the top on the right shows the absolute revenue from the FY14 client cohort, who in their fifth year of trading with IG generated revenue of £33m. The total prospect acquisition cost of that cohort was £40m, which was paid back in the first year.

These clients then have an enduring value as they have continued to generate significant revenue in the subsequent years, and we expect this to continue. This is demonstrated by the example of the FY10 client cohort shown on the bottom of the slide, who in their ninth year of trading with us generated revenue of £29m. You'll be aware that there is a steep client attrition curve in the early months after a client first trades, but those clients who stay with the business continue to generate revenue that recur year after year for many years, and which in the later years does not decline much year-on-year.

This time last year we guided that operating expenses in FY18 were expected to be in line with FY17, and I'm pleased that we were able to repeat that guidance throughout the year. This business can control its costs. The detail of the change in spend in each area and on each cost type is set out in the announcement and I'm not going to repeat it here.

One of the key features of our cost management has been the management of fixed remuneration costs, which at £96m were little changed despite the investment we've made in headcount, which increased in the year by 131 heads, or more than 8%. This reflects the lower average cost per head as a result of off-shoring a number of roles to our non-UK operational hubs. And that wasn't a process that happened overnight, it was a result of many years of planning stemming from the target set back in FY14 to reduce the proportion of our total workforce based in central London, which as the charts on the bottom of the slide show has reduced to less than 50% from two-thirds in FY14 as we have developed our operational hubs in Krakow and Bangalore.

Looking forward, operating expenses are expected to increase in FY19, which reflects the continued investment in new product and platform development, and additional headcount in sales and client service. You should therefore expect to see the majority of the increase in operating expenses in FY19 in the technology and innovation line.

Looking at variable remuneration, the charge of just under £36m is an increase of 52% compared with the charge for FY17. Most of the increase is due to the higher general bonus pool. The size of that pool depends upon the performance of the business against its internal targets for the year, which reflect both financial and non-financial measures. In FY18 we significantly outperformed against those internal targets, and for the prior year we slightly underperformed. We expect that the charge for variable remuneration for FY19 will be lower than for FY18, reflecting the assumption that the business performs in line with its internal targets for this year. Under this scenario the variable remuneration charge would be expected to be around £5m lower than in FY18, which would largely offset the expected increase in operating expenses.

Moving on from income and costs to cash capital and liquidity. Our business is highly cash generative, we receive the cash from our profit the next day. Our own funds generated from operations in the year were 114% of our operating profit, which reflects the non-cash charges in the P&L, and an increase in the working capital net payable due to the increased level of the short-term bonus accrual.

Our investments in FY18 include the £3m final payment for the purchase of DailyFX, £11m of capex, and £4.3m for the purchase of own shares to satisfy invested share schemes for employees. Before dividends the business generated £253m of own funds. Dividend payments in the year totalled £120m, and our own funds balance at the end of the year was £746m. And as the balance sheet shows, the Group is in a strong financial position. Our capital employed has increased to £842m, and at the end of the year we held £872m of liquid assets, including our own funds, £37m of client deposits in IG Bank in Switzerland, and £89m of funds that clients have transferred to us under title transfer arrangements.

On the right hand side of the slide we show the analysis of available liquidity at the year-end, which we calculated the total liquid assets on the balance sheet less the amounts within that balance that are being deployed as broker margin requirement, are held in non-UK entities, or are held within client money. Of the £282m of available liquidity at the end of the year, £83m is required to be held as a liquid asset buffer, and £123m is earmarked to pay the final dividend in October. That leaves £76m of immediately available cash in the UK, part of which is held at brokers in excess of the minimum margin requirement.

Now for the last four years we've also had access to a committed RCF of £160m. The RCF should ideally be used only for short periods, but during FY18 from the end of October through to the end of April the RCF was at least partly drawn. We therefore decided to change the structure, and in June this year we entered into a new agreement, including a £100m three year term loan, and a £100m RCF. The term loan means that we will have the cash balances on hand to handle almost any conceivable liquidity requirement, and to support future growth, and we will still have access to the RCF if an event occurs that we have not envisaged.

Broker margin is the main variable in our liquidity requirements, and the chart on the right shows that in FY18 the level of broker margin continued to increase, with the average up by nearly £90m to £372m and with a new peak margin requirement of £453m.

The key underlying driver of broker margin is the growth value of our hedging positions, which is the red line shown on the chart on the left, which in turn are driven by our clients' position as outstanding, the top blue line, and the extent to which we can internalise. And although not perfect, if there are lots of factors that affect it, there is a decent correlation between the level of broker margin and the level of our revenue.

And to conclude on the financials, I thought it would be helpful to set out in one place the guidance that we've given for FY19. Our revenue is expected to be lower than in FY18, which reflects the impact of the regulatory changes in the UK and the EU, net of the benefit of mitigating action as taken by us and by our clients, which Peter will take you through in a moment.

We expect our operating expenses to increase in FY19, and we expect that increase to be largely offset by a reduction in variable remuneration, which as I've said, if the business performs in line with its internal targets, will be around £5m lower than in FY18.

As a result of the new bank agreement we expect our net financing costs to be around £2m higher than in FY18, and we estimate that the effect of tax rate will be around 19.5%.

So Peter, over to you.

Peter Hetherington

Thank you very much. Next I'll give everyone a quick recap on our business model. It sets us apart from most companies in this particular industry as you all know. I know almost all of you came to our Capital Markets Day only two months ago, so I'm going to rattle through this section.

Cutting a long story short, we want our clients to succeed. Surveys suggest the overwhelming majority of our clients understand that trading is a zero sum activity where individuals will, on average, lose their transaction fees, but within that you have a huge range of individual outcomes.

Our revenue is driven by active clients and their level of activity, it's not dependent on the direction of market movements. We internalise what we can and hedge the balance. The balance which we end up hedging is often big, which means we need a lot of cash in the balance sheet, as Paul's just explained.

Explaining the graph - the blue line at the top shows you what the client's paid us each quarter in spread, commission and funding. The purple line at the bottom shows you what we would have made if we'd entirely hedged each position in the underlying market. And the red line is our actual performance, with the grey shaded area showing you the benefit we get from internalising client flow, which means matching buyers and sellers against each other and only hedging the balance.

So, who are our clients? Let's have a look. Fully half our revenue is generated by less than 2% of our clients. Those clients trade on average 7,000 times a year. 2,700 clients each trading seven times a year or around 30 times a day, that's 19 million trades in the 12 month period. Again as you all know, 80% of our revenue is generated by the most valuable sub 10% of our clients. Over half our revenue comes from clients who've traded with IG for longer than three years. Amongst the top 2% almost a third have been with IG for over seven years.

Could we cast our net wider and bring in significantly more new clients? Absolutely we could, but we do not aim to operate a high churn business model, instead we're focused on building deeper, longer, better relationships with our clients.

So tenure is important, and what are the trends which are driving this business? Firstly, wealth and financial awareness is on the rise. Our product is for wealthy individuals. It's targeted at those who want to place a portion of their wealth in more speculative financial instruments. Secondly, the spread of information via technology has given individuals increased access to information they may not have been privy to before. Finally, this is reflected through regulatory change and a loss of confidence in existing financial institutions, and we're seeing people becoming increasingly self-directed.

These tailwinds we benefit from as a business should not be ignored, much as I like telling our board how tough it really is. Over ten years we've shown an outstanding track record of growth in our business, despite a somewhat hostile regulatory environment, and a huge increase in the number of competitors over that same period.

Let's look at innovation. With an ever-changing landscape the importance of innovation at IG is now more than ever. IG started as a new way to trade gold, and over time we've added over 15,000 markets. Innovation is part of our DNA, it's what we do. We listen to our clients, we let them trade what they want, when they want, and how they want to trade it. We have to keep innovating as clients' expectations are constantly changing.

Let’s now move on and look at regulation. Last month ESMA formally adopted the emergency intervention measures impacting CFDs and binary options. The three month timeline can be rolled over if regulators deem the problem to remain. Where this goes off; that is honestly a bit of a mystery. We think the idea is that national regulators replicate the ESMA rules and so the need for the overarching intervention falls away. Whether all the national regulators do indeed do this is open to considerable debate. As a prudent approach we are planning for these temporary restrictions to become permanent across the UK and EU without being at all certain that this will actually happen.

That is not the only uncertainty. As most of you know there are lots of pretty similar financial derivatives, and working out which ones are caught and which are not is no easy task. We expect all sorts of product development and repositioning by providers in the marketplace.

Let’s now move on and look at some mitigating actions our clients have been taking. First, let’s talk about professional clients. We’ve been talking about professional clients for a full year. In November we rolled out our online upgrade process. This slide updates you on how we’re doing. If you took the 4,600 professional clients we had at the end of June the revenue they generated over the prior three months equates to over 40% of UK and EU revenue.

Guidance has been issued by regulators around what evidence is required, what counts as significant size, and indeed, what is a relevant role in the financial sector. We were pleased that the guidance confirmed our approach.

You can also see that of the 4,300 accepted pros, together with our pre-existing pros, representing over 40% of our UK and EU revenue, and you can see the 14,300 rejected clients, representing 19% of our revenue. This tells us two things. Firstly, bigger clients are more likely to pass. Secondly, it shows you just how much our clients dislike these new rules. For nearly 19,000 clients to apply before the rules are even in force is extraordinary.

This slide has come from a third party analyst firm called Investment Trends who survey the overall industry. It’s quite important what this is showing you. It’s a UK market penetration slide and it shows the number of primary relationships, not volume or value of trades, so it is not illustrative of revenue share of the biggest providers in the industry across spread betting CFDs and FX, the whole leverage trading space. The grey bars show you the overall share of primary relationships, and you can see IG there at 32% across the whole leverage space, four times the size of our nearest competitor.

You can also see that investment trends had 1,750 clients participate in their survey. They have anonymised many of the companies on this side for reasons that are around to become clear. They also ask people to declare the size of their investment portfolio and how frequently they trade, to establish if they might qualify for professional status. They estimate that 12% of current leverage traders would pass based on self-declared trade frequency and wealth.

The blue bars overlaid now show you where those clients that think they would qualify as professional clients currently have their primary account. As you’d expect, the long established firms who have long sought the high end of the market grossly outperform here. The firms who are anonymised did not have any responses at all where the respondent claimed they could be classified as professional.

However, be a bit careful here. It’s only amongst 230 respondents, so the sample size is small which must give a margin for error. We also know that lots of clients think they should pass but don’t when it comes to providing hard data.

Also, 12% of clients being pro looks very high to us. We're currently around 4% of our UK and EU clients being classified as pro, and we think we're definitely nearer the end of this journey than the beginning.

Despite all caveats we're pleased with the UK market share data, the first time it's been done like this, and hope you find the external pro data comforting and directionally useful when considering this sector as a whole.

Moving on. What can retail clients do if they're unable or unwilling to go professional? As a group we have subsidiaries in many financial centres around the world. UK, Australia, Singapore, Switzerland, to name but a few. The client protections accorded by financial regulations in these centres are very similar to those offered in the UK. We have seen some interest from our retail clients located in the UK and EU in contracting with our non EU entities.

In reaction we have undertaken some work to make sure clients have full information about our various international offerings and to make sure our account opening journeys are as smooth as possible. The graph shows the level of interest from clients. We currently have over 4% of UK and EU retail clients by revenue, it's a tiny percentage by number, contracting with non EU entities. The trajectory is accelerating as you can see.

To state the obvious, our non EU entities are not conducting any financial promotion activities in the UK or EU, nor are our UK or EU offices arranging for UK or EU clients' accounts to be transferred.

What else can clients do? Most of you will have seen this before. We all know clients could fund more or run their account with less headroom. This is the third option. On the left hand graph you see that retail clients keep on average about three times the money they need on their account at any one time. On the right hand graph you can clearly see that retail clients use approximately ten for one leverage on their accounts overall. This obviously means that some of our remaining retail clients will not be affected by the new leverage rules at all.

Some of you may also have noticed these lines are all going in the wrong direction. But there's nothing to worry about here. This simply reflects the gradual change of the client base from retail to pro. As you can see, our UK and EU pro client base make up more than half of the cash we hold for them, margin requirement, and notional exposure. We can also see professional clients run their accounts tighter by holding a smaller excess than retail clients.

Some of you may wonder why professional clients don't bring in more revenue than retail clients based on these lines. That's because the bigger clients have, as you'd expect, negotiated better terms with us, in fact they always have done. So even though more than half our volume is from professional clients they pay less.

What else can clients do? Within the CFD space we expect clients to switch the types of instrument they trade. One example, the Spanish index, the IBEX and the DAX, the German index, used to have similar margin rates, however, under these new rules there becomes 100% difference in the margin clients must post, with clients trading IBEX requiring to post double that of those trading with DAX. We therefore expect clients to modify what they trade to minimise their margin they need to get the exposure they want, especially where assets are highly correlated.

Finally, option five is where we do expect some substitution between products. By products I mean the likes of futures, turbos, CFDs, swaps, options etc. Long story cut short, CFDs have been made relatively less attractive than other leverage derivatives by these changes. We have a long successful history of innovation, so expect us to do something interesting in the leverage derivative space soon. And in addition, please note that our MTF offering does not fall under this option five. We'll come on to that separately.

The demand for leverage products is very strong. We fully intend to be part of the solution to this demand. Please also remember that we will continue to seek the same high end clients as we have done for very many years.

Let's now look at the marketing landscape, which again is pure recap. As many of you are aware, large technology firms are restricting what companies selling CFDs can do. They're ensuring that apps, ads, payments, etc. are only served or transacted in places where firms supplying them are explicitly licensed.

Plainly this is a good thing. Some are also banning or restricting the offering of binaries or crypto products, even where the offering is perfectly regulated and authorised. That is less good. We think our strategy of having proper licences is obviously the right sustainable answer. The likely licensed or unlicensed end of the market do not like these new rules at all.

Separately we've developed and deployed our Progressive Web App, our PWA, around the world. This allows us to get our dealing platform on clients' phones even when an app store owner decides they do not like some of the products.

This brings us to our final section, future growth. Our recipe for growth revolves around three main levers: growth from within our existing footprint; growth from new countries; and growth from innovation. Again this was covered at length in the CMD so I'll be mercifully brief.

We expect to grow our market share in existing countries. We provide access to products the clients request, like Bitcoin back in 2013. We offer now over 15,000 products. We rebuilt our web platform to make it best in class. We introduced the Progressive Web App so you don't have to download our app through an app store. Finally, we tailor the service a client receives basis their needs. Our biggest clients get an amazing personalised service.

We also expect to grow from entering into new countries, with a proven track record of being able to do this successfully. Back in 2002 100% of our revenue was from the UK; now it's less than half. If we look at our two most recent examples, Switzerland and Dubai, both are performing really well. We anticipate that we will shortly receive our licence to offer retail forex in the US, which we'll come onto in the next slide. And we currently have pending applications in two other countries.

As I just mentioned, we hope to shortly acquire our licence to operate in the US as a retail forex dealer. We believe this market is currently underserved following the forced exit of the largest provider of services last year. There are around 85,000 active FX traders in the US. These clients have over $500m lodged with the three brokers active today. We think this is a decent opportunity. There are also synergies with our DailyFX brand and Nadex which will help drive client acquisitions, and with a combination of high regulatory and significant financial barriers to entry.

Our final lever of growth is growth through innovation. And the big thing on the list is the multilateral trading facility for the European market. The MTF is both an offensive and a defensive play. It's offensive because there is a huge on-exchange derivative market in Europe catering for retail clients. The number of on-exchange traders in Europe is estimated at three times the number of OTC traders.

The MTF is defensive because it gives us a leverage product for retail clients in Europe that currently sits outside the CFD regulation. We plan to issue turbos which are well understood and well regulated. They are not caught by ESMA under the leverage restrictions. There were over a million new listings of turbos and warrants across the European market in the last quarter of 2017.

Professional traders will be able to trade our existing OTC products unaffected. But the MTF allows us a safe harbour for our prospective and our existing European retail clients.

To sum up, the MTF will give us not only a sustainable safe harbour, but an additional platform in which to grow our European business.

And so to the conclusion. We're a business that provides people access to opportunities in financial markets, and the exact detail of the product we offer is becoming increasingly irrelevant. I hope this regulatory hiatus should finally make everyone realise that we're a responsible business with the interest of our clients driving what we do. In future years I hope we'll be talking about our broad leverage offerings, with the product specifics increasingly irrelevant and without the backdrop of regulatory change.

Every company you guys follow will doubtless tell you how different they are from the others in their sector. We're no exception to this, but I hope you'll agree with us that both in how we operate, who we target, and the open way we communicate with you, that we're very different from those you may choose to compare us to.

So, we're the undisputed number one in our sector. We build our own tech and it's good. We really care about client relationships and service. We take risk management seriously. And good conduct runs through everything that we do. These five points help support our final point, our business model. This allows us to align our interest with our clients to sustain our business model in the long term.

So, to conclude. FY18 has been an excellent year for IG financially. We've achieved record revenue and record earnings for the year. IG has been a sustainable business for more than 40 years. We're well positioned to mitigate the impact of regulatory change, we're well positioned to deliver sustainable growth, and we're making investments for future growth. We're confident in the strategy and financial outlook, and as a result we expect to maintain the 43.2 pence per share dividend until earnings allow us to resume progressive dividends.

Thank you all very much for your time. One little bit of housekeeping before we move to questions: please remember to introduce yourself and who you work for. To prevent confusion please ask one question at a time. We won't stop you asking follow-up questions.

Q&A

Question 1

Hayley Tam, Citigroup

Two questions, but one at a time. The first one, in terms of the guidance you've given in the past about this 10% pro forma hit, if we think of it that way, would you mind reminding me does that include any sort of internalisation benefit reduction if there's less volume trade overall? Or am I barking up the wrong tree?

Paul Mainwaring

No, not barking up the wrong tree, but the vast majority of the volume doesn't come from the people who will be affected by the ESMA regulation. So, it should not affect the internalisation benefit.

Hayley Tam

Thank you. And then the second question was actually about the implementation of permanent rules by the national regulators during hopefully the next five or six months. Have you had any indications from different regulators as to if they are going to implement different rules? And I guess if there was any chance for regulatory arbitrage within the EU how would you respond to that?

Peter Hetherington

Yes, we have had some guidance around what people are expecting to do. The FCA have said that they're going to launch consultation in Q4 of this calendar year, so in the last quarter of this calendar year, and they're going to consult on the extent to which they make the ESMA rules permanent in the UK. So, that's thing one.

Thing two, we have heard informally of at least three different NCAs who are saying that they're not minded to implement the ESMA rules. That obviously creates a problem if this short-term intervention is only going to be removed once everyone's implemented their own national rules. If some of the national regulators are saying they're not planning on implementing their own rules where does it go and how does that fit with the whole question of subsidiarity and all other good things?

And then what happens if, if, if – if you don't mind I'll pass on that one for now because we haven't quite got our heads round that. But what I was trying to make clear in the slide is I think the overall intention was clear, I'm just not sure that the practice will quite match the intention. But we don't know; it's not within our control.

Does that answer it?

Hayley Tam

Thank you.

<u>Question 2</u>

Ian White, Autonomous

I also have two please, which I'll ask one at a time. The first one just on the revenue performance in Q4, obviously it's quite strong and my understanding is that the underlying driver really is a pick-up in overall market volatility. Is that a fair assessment of the driver of the strength there?

And related to that does that make the Q4 2018 revenue number, should we think of that as a reasonable jumping-off point for FY19 revenues post ESMA etc.? Thank you.

Paul Mainwaring

There was a pick-up involved in February, so just at the end of Q3. To some extent that continued in Q4. I wouldn't say it was the biggest driver.

Peter Hetherington

Is it a fair jumping-off point?

Paul Mainwaring

Each month is different. To compare Q4 with then the Q1 in the summer isn't always a great comparison. I think you're better frankly looking at the overall stats for the year as a starting point.

Ian White

Okay, that's clear, thank you. And my second one, please, just on the impact of ESMA's interventions coming up next week have you seen anything in the competitive environment so far that leads you to conclude that there's already a shift towards capacity withdrawal by competitors? Are you seeing smaller firms in particular getting ahead of the regulation, or do you think there's going to be some time before we see the full effect of, say, higher capital rules for firms offering limited risk accounts etc. working through the industry?

Peter Hetherington

I think it will take a little while to shake out. I think people in the industry always assume that things are going to happen more quickly and more suddenly than they ever do. I think it is inevitable, if you look at the industry as a whole, there are an awful lot of firms in the industry who are not profitable. And as they target the lower end these rules are going to be really tough for them. So, I think it's reasonable to expect an industry shakeout.

You're right that also capital requirements are going up for the matched principle firms rather than the firms who can take risk and so forth, so that also will have an impact. But every time we expect dramatic change from regulatory impact it's always smaller and slower than we expect. So, it's easy to get overly excited I think.

<u>Question 3</u>

Paul McGinnis, Shore Capital.

Two questions again. First one, have you seen any evidence to date – I know you were quite clear in your own presentation about how you've not been promoting the potential use of non-EU based regulated subsidiaries – but have you seen any evidence elsewhere that that's been an attempt to kind of get round the regulation? And should that be the case it kind of drags the whole thing back to square one, and whether you might consider something different potentially basis on where the client is actually based rather than where the operator is regulated?

Peter Hetherington

I heard the first part I'm not quite clear I've got the second part. Yes we have seen some firms based well overseas, nowhere close to the EU, advertising into the EU. The regulators are very interested in that and are cracking down on that hard. So I think the potential for people from outside the EU to actually solicit and advertise in the EU is being very seriously constrained, and is likely to be almost impossible for them to do – my guess.

Where this goes beyond that, I think it is a very well understood tenet of financial services that you as an individual are perfectly allowed to open an account pretty much anywhere you like in the world, but those if they're outside the EU they can't advertise. And that's clear across all of financial services. Whether that moves I wouldn't like to comment.

Is that okay?

Paul McGinnis

Fair enough. And then the second question, just go back to the proportion of revenue that you were expecting to ultimately go on the professional designation, the fact that it was up to 40% - I think was it by the end of June that figure?

Peter Hetherington

Yes.

Paul McGinnis

It just didn't feel like, it didn't seem to leave a lot to do potentially. Were you expecting to reach that 50% level by the start date or somewhere beyond that?

Peter Hetherington

What we always said was once the rules are in force we expect to be at 50%. So, I think you always will have a bunch of clients who ignore all attempts at communication until actually they can't do what it was they were able to do the day before, and that then gives them the impetus to actually apply or not for a different status if they choose to.

So, I think we're exactly where we thought we would be. We're pleased we went out early with it. We're pleased we actually are 80% of the way there. But let's not forget, these rules haven't even come into force yet, and almost 20% of our EU and UK clients have applied for professional status. That to me is a staggering stat.

Paul McGinnis

Agreed. I'm just wondering what on earth is going to get the last few over the line if they haven't already applied.

Peter Hetherington

If you look at our revenue, more than 40% is pro, and then we said another 19% had applied and not yet supplied the data, so that gets you to kind of 60% of revenue. So, 40% of our revenue has done nothing so far.

<u>Question 4</u>

Alastair Ross, Investec Securities

Quite a few questions from me. Sorry about this. Just in terms of mitigation and your points on mitigation, and also the fact that you see constraints applied to other brokers as well as the fact that you have clients opening IG accounts outside the UK and EU, what level of mitigation do you foresee when you talk about the 10% pre-mitigation?

Peter Hetherington

The 10% assumed 50% pro, to be clear. It assumed nothing else whatsoever. We're not giving any further guidance on what we expect numbers two through five to come to.

So of the five mitigations I went through the 10% included number one, didn't include two through five in any way, shape or form and I think Paul would chase me out of the room if I tried to.

Alistair Ross

And what do you think the market is expecting? I mean I myself expect sort 20% but I don't know where the rest of the market sits and obviously it's a huge factor here.

Paul Mainwaring

It is and we'll share the consensus with you after if that's okay, so you can just see what the range is. There is a range of views.

Alistair Ross

Thanks. Just going back to Q4 trading and more explicitly May trading and June, July, clearly Capital Markets Day you guys guided to a revenue figure, beat that revenue figure, you could pretty much work out what PBT was going to be, you beat that figure as well, just in terms of trading in May and given that crypto fell off a cliff in Feb.

Peter Hetherington

It wasn't crypto

Alistair Ross

No, no, no it wasn't crypto because crypto fell off a cliff so what exactly was the big driver in May and is that driver prevalent in June and July?

Peter Hetherington

I don't think May was that exceptional, I just don't think we wanted to go out with figures on the 23rd May and then fail to meet them when you announce them six weeks later. So we were obviously slightly cautious and we said it will be over 565 is what we said for revenue because we just wanted to make sure that we were safe, because we've got a very careful finance director.

Alistair Ross

Wonderful, just music to my ears. Just in terms of slide 26 do you know how many of those clients have applied for professional status?

Peter Hetherington

No I do not but if I had to guess I'd say most of them have applied and failed for professional status. I would also say if you look at the numbers on the professional you've got 19% of revenue or 14,000 clients who've applied and failed. And by applied and failed what I actually mean is applied and not yet passed because what we say is you need to prove it and then if a client fails to prove it we are calling them rejected, they're not truthfully rejected, they can at any point, and I'm sure some will, when the rules come into force, actually provide the evidence they need to change their status.

Alistair Ross

Okay on slide 9 why is it that existing clients are trading so much more? I mean I know part of it is driven by cryptocurrencies, so £26m you said was driven by cryptocurrency, what exactly is the £22m? Is some of that, I mean I suspect, share dealing and investment cross-sell but what exactly is the other £22m?

Peter Hetherington

It moves around, it moves around every year. If you go back on this bridge and look over the last few years it probably wasn't purple at the time but the purple blocks have been either pluses or minuses, clients trade what is interesting in the underlying markets when they want to, assuming we haven't done anything to particularly annoy the clients they will naturally come back to us when they choose to trade because the market is interesting. We are an execution-only company at its heart, clients trade when they want to not when we want them to.

Alistair Ross

Okay just on the next slide am I right in thinking the $40m investment that relates to the £52m am I right in thinking that you've said in the past that clients pay back within three to four months, am I right?

Peter Hetherington

Yep.

Alistair Ross

And if I look at that bar chart there the investment, obviously the £40m doesn't relate all to the same, I mean those are future clients, is that right? Am I thinking about that in the right way, because I think that shows a nine month payback?

Peter Hetherington

It doesn't because if you look at the left-hand side you can see that after three or four months on that the clients have paid back the £1,200 it cost to recruit them, very clearly. If you look at what we spent on marketing don't forget that in year one those clients only have half a year on average.

Alistair Ross

Yeah that's exactly it.

Peter Hetherington

So actually what this is showing we spent £40m, in six months of trading clients were worth £52m, so it does actually all fit to the same number.

Alistair Ross

And then the last question that goes back to a question asked earlier, just in terms of the level of internalisation am I right in thinking that that should decrease given the revenue makeshift?

Peter Hetherington

No.

Alistair Ross

So it should increase?

Peter Hetherington

It's a difficult subject because how well we internalise depends on what the clients trade which is not within our gift. So if you look at Paul's slide and you look here at the margin requirement, the margin requirement fell heavily back in February '18 and it fell heavily because clients went from being long indices and long shares to being short indices and long shares which suddenly allowed us to internalise much better because you can net the exposures off against each other.

If everyone's buying you can't internalise it; if some are buying and some are selling you can internalise it. Our clients are always long individual equities, for as long as I've been here, they flip around on whether they're long or short of indices and the extent to which clients go in the same direction changes dramatically over time.

So the amount that you internalise is very difficult to forecast forward which is why we keep so much cash on the balance sheet because if they all go in the same direction you need cash to make sure you don't end up with residual exposure.

Alistair Ross

And then just a last question, sorry, on a point you made in terms of the consultation in Q4 regarding the FCA do you foresee them implementing the same sort of leverage limits or do you think they could be more punitive?

Peter Hetherington

I don't know truthfully. I think they've said they will consult on the extent to which they will implement the ESMA measures, so I would read that as somewhere from what ESMA said to something less, but I could be absolutely wrong on that reading.

Question 5

Richard Taylor, Barclays

Could you expand please on this, what you make about the new OTC leverage derivative plans? Can you give us an idea of what these products are and whatever they are why is it fair to suggest that's good innovation versus potentially sidestepping what the regulator's trying to achieve by looking at CFDs?

Peter Hetherington

What you've got is, let me find the slide before we get there. So you've got a number of products that existing retail clients already use across the EU, it's not sidestepping the rules for a company to start offering one of the pre-existing products, there's no way that could be described as sidestepping anything, we can choose to be active in any business segment that we choose to be active in.

The underlying problem here is that all of these products used to be margined basis risk, so the margin that a client needed to put up was determined by the riskiness of the product. What's happened under this intervention is that one product, CFDs and spread betting, is margined both basis risk but also basis a social desirability overlay. That has upset the applecart in terms of these products and created a competitive disadvantage for CFDs relative to all of these other leverage products.

As a result I think it's reasonable to expect clients to choose to jump wrapper, whatever you want to call it, whatever the underlying thing, the swap forward, turbo, CFD, whatever, clients will jump what they're trading, they'll still continue to trade the same underlying so if they were trading the FTSE they'll continue to trade the FTSE, they'll just do it through a different vehicle.

So you have to expect clients will jump product, you also have to expect firms will change their offering to reflect this unlevel playing field. That cannot be circumvention in any way, shape or form.

You went on to ask what are we going to launch and when and if you'll forgive me I'm not going there.

Question 6

Ian White – Autonomous

I just wondered if you might be prepared to share a bit more detail on the two emerging market licenses you mention? Would these be entirely incremental in terms of revenue or do you derive some revenue from those jurisdictions already? And in terms of quantum can I think of them as another Dubai or is it something much smaller than that?

Peter Hetherington

No we don’t derive any notable revenue from them today and no you should not think of them in the same quantum as a Dubai or Switzerland, you should think of them as materially smaller.

Thank you all very much for your time.