IG Group

Full Year 2014 Results

Tuesday 22nd July 2014

Christopher Hill, Chief Financial Officer

Good morning everyone and welcome to the IG FY14 results presentation. As most of you know, I'm Chris Hill, CFO, and with me is Tim Howkins, CEO.

As usual, I will walk through the detailed performance for the year and Tim will look at the progress that we're making on our strategic initiatives.

So getting straight in: slide 3. Overall revenue for the year was £370.4 million, up 2.4%. We had PBT of £194.7 million, up 1.3%. Diluted EPS came in at 40.18p, up 3.6%. The effective tax rate was down to 24.5%, compared to 26.3% in 2013, reflecting the progressive fall in the UK corporation tax rate. And the business continues to be highly cash generative: £160.6 million of own funds generated in the period, 4% ahead of last year.

We are proposing a final dividend of 22.4p, which brings the full year dividend to 28.15p, up 21%.

You'll have seen in the statement that the Board is raising the ordinary dividend pay-out ratio from 60% to 70%, effective from the 2014 financial year. This is a clear reflection of our confidence in the cash generation of the business and is underpinned by a solid balance sheet.

Simultaneously, the Board will adopt a new policy of paying the interim dividend each year, calculated at approximately 30% of the prior year's full dividend.

A bit more P&L detail here on slide 4, the Income Statement. The headline numbers we've just been through, but also of note, second half revenue of £187.7 million was down 2.7% on last year, with all of the weakness coming in the latter part of the last quarter. Q4 was down by 13% against the record quarter last year.

The subdued markets towards the end of the year are well documented and we flagged this in our Trading Update at the end of May. As you'll see later, this weakness was particularly noticeable in FX.

Active clients for the full year were down 7.3%, with average revenue per client up 10.4%. As we've made clear before, this pattern is predominantly due to management actions to de-emphasise clients with exceptionally low levels of activity. As this washes through the client base, I wouldn't expect this pattern to continue. Tim will speak a bit more about this later on.

Lower betting duty was more than offset by lower yields on client money, mainly the reduction in Australian interest rates over the last two years. We could see this number drop again in FY15, before stabilising and beginning to rise.

Other income is mainly from the three year revenue share on the disposal of the Sport's business in June 2011. That has now come to an end, so I expect this line to be near zero going forward; only inactivity fees will remain here.

Operating costs, which I'll cover later, were up 3.3%.

So, to the Revenue Bridge, slide 5, a slide format you'll be familiar with. There's nothing too surprising here I think. Looking at the left-hand side, at H2 2013, you'll remember the typical pattern when moving from a quiet H1 into a busy period. You get big increases in revenue, particularly from existing clients trading more and new clients joining.

The two halves of FY14 were quieter and look quite similar. We see reductions in current clients trading and less of an uplift from new clients. However, in both halves the additional revenue from returning and new clients outweighed the attrition from existing clients not trading.

Turning to slide 6, we've provided some additional detail here, but again, I think this is in line with what you would expect. Looking at revenue and clients by country, there are a few observations worth making. UK revenue up 3.3%, with client numbers down 13.2%. As Tim will show later, the sequential client numbers are much more stable.

There is undoubtedly an FX impact coming through in Asia Pacific, where FX is a much bigger piece of the revenue mix, with Australia down 7.3%, Singapore down 10.3%, and Japan down 23.4%. You'll recall that the impact of Abenomics at the beginning of the second half of last year, and then towards the end, the market concerns about the tapering of QE, caused extreme volatility in currencies in that region, so the prior year comparator was very tough.

In Australia, the impact on revenue is somewhat exaggerated by the weak Australian dollar, when the results are translated to Sterling. However, it is tough here, and one key Consumer Confidence study showed it ending 2014 at its lowest level since 2009.

Europe remains strong. Revenue is up by almost 16% and client numbers by nearly 6%. We saw good revenue growth from our four biggest European markets. Germany and France both grew strongly at 19.8% and 15%, with both showing a strong uplift in client numbers. Europe continues to have great potential.

On slide 7 we look at the asset mix in revenue. You can see clearly here that the end-of-year weakness is really an FX story. FX revenue is down year-on-year by around 14%, with half two down year-on-year by 31%. The chart on the left shows the pick-up in FX in Q3 '13 with Abenomics, and into Q4 '13 with tapering concerns and their impact on emerging markets. Followed then by the steady decline through the 2014 Year and a very quiet Q4.

I think the other thing that comes out in this slide is the benefit of being a broad multi-asset business; they are rarely moving all in the same direction at the same time.

Across the year, indices and shares were really quite strong with the markets bouncing around all-time highs. Indices revenue was up in the year by 4% and shares was up by 13%.

On slide 8, once again you see on the right a tight distribution of daily revenue, and then on the left, the variability of revenue remains very low, that dark line, while average revenue has grown over the years. This is the result of strong risk management and no proprietary trading.

Turning to the operating cost detail on slide 9, as I said earlier, operating costs were up by 3.3%. Around half of the uplift came from variable remuneration against a weak year in 2013, but there are a couple of details that I would like to note. As we said in the IMS in March, the FSCS charge was a little lower this year as there was no interim levy.

Going forward, the statutory accounting for the FSCS levy changes, which I'm afraid makes for a difficult H1 / H2 comparison. We must now recognise the whole estimated annual charge on the 1st of April each year, and therefore there will be no FSCS charge in the first half, with it all now falling in H2. Prior year comparatives will therefore be restated.

The bonus accrual was 26.5% of the total salary costs, but you'll notice the pickup in the cost of share-based schemes. The new remuneration plan for the executive management, the Sustained Performance Plan, means there is no longer a cash bonus; it now entirely comes through as a share-based scheme. And just like at the half year, there was a doubtful debts charge. We mentioned that last year brought to an end the large legacy debt recoveries. The underlying doubtful debts charge remained at less than 1% of revenue.

Again here, I will finish by reminding you we continue to expect a significant uplift of costs in FY15 to support initiatives such as Switzerland, Dubai, stockbroking, and the mobile development.

On to slide 10 to have a look at cash. It was, by any measure, another good year for cash delivery. This, and our confidence in the future cash generation, drove the Board decision to increase the ordinary dividend pay-out ratio to 70%. Own funds generated from Operations was up by 4% to £160.6 million. As is traditional, we saw a working capital inflow in the second half of the year as we book up the bonus charge in preparation for paying in H1. Own funds increased by around £60 million, to end the year at £487 million.

Broker margin ended the period near its intra-year highs at £285 million. The scenario that we saw at the end of the year with equity markets bouncing off highs means that clients tend to be in shares, with a greater leaning towards smaller cap where the margin requirements are higher, and also carrying short indices positions overnight, waiting to benefit from the fall. Net own cash available, after posting broker margin, was £202 million. On the right-hand side, we show how the £202 million is put to use.

Overseas regulatory and working capital ties up around £29 million. I should say here that this will increase by around £15 million once Switzerland is trading. And after funds required for segregation, which is really a timing difference on card funding and some regulatory buffers, own cash is £153 million.

You will recall the liquid assets buffer of around £82 million, this hasn't moved since the half-year, and of course we had the enhanced dividend to pay in November. The facility remains at £200 million, and this was undrawn in the second half of the year.

On to slide 11, Regulation. Our overall message here is that there have been no significant recent developments. In Europe, the Financial Transaction Tax debate continues. The rhetoric suggests that there is increased political will, but there's no clear evidence of material progress.

European Market Infrastructure Regulation brings with it some additional trade reporting requirements but we are addressing these, and the Market in Financial Instruments Directive is scheduled to come into force in January 2017. The Level I text has been released, and the Level II has some way to go. We're monitoring this carefully, but to date we see it as having no significant risk to the business.

Japan binaries you know about. Net net, this looks to be somewhat beneficial. And Singapore leverage we've been flagging for a couple of years now. Our best estimate is that this will come into force in 2015.

And lastly, as per Tim's statement, there have been client knowledge restrictions in Singapore for some time, which have negatively impacted the flow of new clients to the industry. An e-Learning module has just been approved by the regulator and introduced. We hope that this will have a positive impact.

So, to finish, slide 12. Although things did finish quietly in May, we should remember that this was a record year for IG in terms of top and bottom line. This business remains highly cash generative. Our confidence in future cash flows has enabled the Board to raise the ordinary dividend pay-out ratio from 60% to 70%, whilst maintaining a progressive dividend policy. And we retain resources and headroom to fund our future significant growth plans. With that I'll hand over to Tim.

Tim Howkins, Chief Executive

Thanks, Chris. Good morning everyone. As Chris has already said, this was a year in which we delivered growth in revenue, in profit, and in cash flow. That growth would have been higher had we seen higher client activity levels in the last few weeks of the year, but the last few weeks of the year were characterised by very, very, dull markets and client activity levels accordingly quite muted. Those conditions really continued into June and the first half of July, and I'm sure many of you have seen the same sort of thing in your own business.

Every year we expect to have some quiet months, some busier months, and I really don't think at this stage in the year you should read too much into what has been a slightly slow start.

Putting aside the numbers, more than anything else, this was really a year of delivering on some key longer term initiatives. In particular, we finished off the development of our UK stockbroking offering and we completed our Swiss office. We've also been in very constructive discussions with the regulator in Dubai, and those are all initiatives that I'll talk about in a few minutes.

First as Chris has already indicated just a few words on client numbers, active client numbers and revenue per client which is something we've talked about for a few quarters now. You will recall that through the second half of the prior financial year we were making a number of changes in the business which had the effect of de-emphasising or discouraging absolutely clients, clients generating virtually no revenue, I think the left-hand chart here very clearly shows the impact of that which was that there was a one-off step change, a step down in active client numbers, particularly in the UK, between Q4 of last year and Q1 of the year just ended, and that thereafter active client numbers have been stable or indeed in some cases growing.

The right-hand slide shows where those changes had their effect and you can very clearly see the impact on the red line. The red line is the proportion of new clients whose revenue per month is less than £1, so absolutely tiny clients and our view was that they were a very disproportionate load on both customer service and on compliance for effectively no return at all. I think you can also see in that slide that both the green and the purple lines trended up quite strongly and those are clients whose revenue per month is between £25 and £100 and £100 and £1,000. So driving up the mid-ranking clients whilst discouraging absolutely tiny clients.

I think the effect of those changes that we made 12 to 18 months ago have now pretty much washed through. Having said that we are about to launch stockbroking, we're making some changes to our mobile offering and I think both of those initiatives might have some impact on revenue per client going forward. Ultimately we're not focused on any particular figure for revenue per client, we're interested in growing overall revenue and overall client numbers.

Turning to slide 16 we've been working on two new country initiatives over the last year. I had hoped that I'd be able to stand here this morning and say that we were open for business in Switzerland; we're not quite there yet but we are very much in the final stages.

We're literally just waiting for FINMA, the Swiss regulator, to grant us our licence. We're clearly heading now into the summer holiday period so even if we do get our licence before the summer, which is looking less likely, I think it's unlikely to be before September that we actually start generating revenue in Switzerland.

Dubai is at a much earlier stage. We have been in dialogue with the regulator for a long time. We submitted the first step in our application to the regulator last week; clearly therefore some way to go and very much in the hands of the regulator, but at this stage we'd anticipate that at some point in 2015 we will be opening up in Dubai.

Both of these are countries where we already have some active clients dealing with us through our other offices, and both are countries where we anticipate good levels of demand.

In the case of Dubai we're not going to be focused just on Dubai itself, we very much see this as a platform for addressing the wider United Arab Emirates and, ultimately, over the longer term the wider Arabic population worldwide.

We do continue to do development activities in other countries, both talking to regulators and talking to potential local partners. All of these activities are at a much earlier stage and certainly at this stage there are no other countries which are imminent.

Turning to slide 17 and NADEX. NADEX continues to grow at a good pace, albeit that it is growing from a relatively low base. Revenue was up 55% year-on-year. In April we saw two market makers join NADEX, one of which has been adding liquidity consistently into the exchange since then. The effect of having this additional market maker has been to narrow effective spreads across a number of markets, and really just to make the market look more credible, more attractive to potential clients. Over time we'd hope that this would be one of a number of things which has the potential to accelerate the rate of growth in volumes and clients.

Turning to slide 18: Stockbroking. As I said earlier we've substantially completed the development for our UK and Irish stockbroking offering and we've been testing this internally for several months now. We've literally in the last few days started to pilot test it with a small number of external clients.

As a reminder we're very much targeting active traders, so while there are about 750,000 people in the UK who trade at least once a year with an online stockbroker we're really interested in the top few layerss of that audience, the top few tiers. There are about 50,000 people who trade, on average, once a week or more with their stockbroker and I think that's really our target audience.

Something like 60% of our spread-betting and CFD clients in the UK have an online broking account somewhere else. Feedback so far has indicated an appetite to try our stockbroking service, particularly if we give them the ability to use their stock portfolio as collateral to support their shorter term trading with spread-betting and CFDs. That is something that we'll offer shortly after launch.

I think for me the big attraction of offering stockbroking is that it allows us to engage with a much wider audience. Some people decide that our current products are not for them without ever really considering them or properly understanding them and I think once somebody has got that mental state it's very difficult to communicate with them, they simply tune out our advertising and PR efforts. I'd hope that by being able to talk about a more mainstream product, which they understand better, we'd be able to capture their attention and, over time, win them, not just as stockbroking clients, but potentially as clients for the rest of our product set.

I therefore expect that in the longer term we'll see incremental revenue not just from stockbroking itself but also within the spread-betting and CFD revenue lines. In the near term I would expect that most of the early adopters of our stockbroking service will be existing spread-betting and CFD clients, either clients of ours or clients of our current direct competitors.

Turning to mobile on slide 19: the chart shows that something over 30% of our revenue is now coming via our mobile apps. As you can see both iPad and Android are growing strongly and have recently grown at a faster pace than iPhone. Our current suite of mobile apps are ideal for existing clients but they don't cater so well for the needs of prospects, people who are still considering IG and its products, and for brand new clients who are learning how to trade. We've recently established a development office in Eastern Europe where we found the necessary IT and marketing skills to address the early stages in the client journey. Over the next two years we'll be progressively releasing new suites of apps aimed at these earlier stages in the client journey. And then as these apps begin to roll out and we're better able to convert app downloads into trading clients we'll increase the amount that we do to directly promote app downloads with both online and in-app advertising.

So in conclusion while we did see growth in both revenue and profits and in particular strong growth coming from our European businesses this was really a year about delivering on some of our longer term initiatives. Of these the key ones are stockbroking and Switzerland, both of which we expect to launch in September.

Mobile continues to be an important subject for us and our focus is shifting to the early stages of the client journey, educating, recruiting and converting clients. We've increased our dividend payout ratio reflecting our confidence in the strong cash generation of our business.

In November IG will be 40. We've grown both revenue and profits in virtually all of our 40 years against every conceivable backdrop both in terms of economic conditions and market conditions.

We've continually evolved and developed our business in the light of changing circumstances, we moved from being a telephone-based to an internet-based and now increasingly a mobile-based business. We've moved from being a UK-only business to now having half of our revenue coming from 14 overseas offices outside the UK.

Our aspiration is to be seen as the default choice for active traders globally. Our new stockbroking offering is an important step towards achieving that aspiration and will, I hope, stimulate stronger growth of our UK business. After 40 years I think we're well-placed for continuing growth.

Thank you. And with that I'll open it up for questions.

Q&A

Question 1

Cormac Leech, Liberum

Three questions if I can? The first one is on the headcount actually I think there's about a 15% increase in headcount year-on-year and I think it’s about 7% up on an average basis; I'm just wondering could you comment a bit on are most of the people you need in place already or do you envisage increasing your headcount further over the next few months?

Christopher Hill

On headcount the increase in headcount is really driven by IT, and as Tim has talked about we are doing a lot around mobile and app development and making those platforms more accessible to people who are now coming to IG and wanting to learn about IG purely in the mobile space and you need to make sure that the platform that you've got is conducive to those sorts of people. It’s now a different set really to what you see from a browser based perspective.

Cormac Leech

Okay, so just related to that actually you talked about hiring some IT and development people in Eastern Europe I think, but you don’t actually say what the headcount actually was there; I'm just wondering is there a potential strategy to shift your allocation of IT people to lower labour cost geographies?

Christopher Hill

Well some of the increase in headcount related to that, as you've pointed out has already come through, and that is going on in Eastern Europe, and we’ve still got some more heads to hire there. We’ve had a development place in Bangalore for a little while now and it is something that is interesting to us, to understand actually how you can get those development sites going.

Tim Howkins

We’re not shutting down our UK IT department, just in case any of them are listening.

Cormac Leech

Understood. And the second question is around the marketing spend, I think you spent about £32m sterling on advertising and marketing, and it may be strategically confidential but is there any colour you can give on how much of that was online because I think you talk about increasing your investment in pay-per-click to basically strengthen the IG.com brand? So what’s the mix online/offline in terms of that advertising spend? Do you disclose that?

Christopher Hill

Broadly half of it is serving banners or pay-per-click and we did dial up the pay-per-click at some stages during the year. But the composition is broadly consistent with what we've had before.

Cormac Leech

And just very briefly the last one you talked about geographically expanding into Switzerland and Dubai. Three to five years out could you give some idea of how you see the business plan in terms of size? Could they potentially start to become half as big as Australia? You must have some base case estimates in terms of the revenue opportunity in Switzerland and Dubai combined?

Tim Howkins

I think the way we're looking at each of those offices is they're of a similar sort of potential to say an Italy or a Spain. I think they're somewhat smaller an opportunity than somewhere like Australia.

<u>Question 2</u>

Hugo Mills, Citigroup

Just a couple from me please, just on Dubai and the United Arab Emirates, is the product set going to have to change at all for that market, I guess that's the first question or can it be very similar?

And secondly, just on mobile strategy in a way it feels like, or to ask another way, what's the typical profile of the customer you're seeking to attract there because it feels like almost you're going for smaller customers again, and how do you screen those out to make sure they're valuable customers, I guess?

Tim Howkins

There will be some minor tweaks to our product offering in Dubai, partly to reflect not paying interest and therefore products with a daily roll rather than an explicit payment of interest, and also potentially reflecting the fact that Sunday is a business day in that part of the world. Currently we don't offer any markets which are open on a Sunday. That's certainly something that we are looking at. Sorry, your second question was?

Hugo Mills, Citigroup

Second question was just around the mobile strategy going forward. It sounds like just hearing it at the moment, it sounds like it's a more simple strategy to try and get new people onto the system. I guess given you've spent the last 12 months paring back and getting more valuable customers, how are you going to ensure that you get relevant customers?

Tim Howkins

I think to be clear, what we've been doing is discouraging clients who were effectively worthless, the clients in the sub-£1 camp. We have seen growth in that £25-£100 and £100-£1,000 band. The evidence so far is that clients who come through mobile are a bit younger and a bit lower value than the average. I think over time that will shift in exactly the same way as 10 or 11 years ago, when we moved to becoming an internet business, initially internet clients were lower value than clients who applied filling in the paper application form. But that mix shifted over two or three years.

Question 3

Arnaud Giblat, UBS

Two questions for me. First on Europe. Could you give us a bit more colour as to how the underlying market is growing, whether there are new clients adopting CFDs from warrants or other sorts of levered products? Is the growth there coming from new clients, or are you gaining market share from competition?

Tim Howkins

It's a slightly mixed position across Europe, slightly confused by the fact that we get market data at different points in the year. The most recent data we've had is from Germany which did show that the overall market was growing and that we were also gaining market share, despite the fact that a couple of the large online brokers in Germany have been quite active in promoting CFDs and they have built some market share. Despite that we gained market share over the last year.

Arnaud Giblat, UBS

Secondly, on stockbroking. Your trial period, what is that showing you in terms of potential velocity of underlying clients? You mentioned one trade a week is your core market for stockbroking. What's the potential value traded there? A bit more colour in terms of the size of the market.

Tim Howkins

It's far too early to draw any conclusions from the pilot group, it's been running basically a week. We've got literally a handful of clients up and running on it, and they are very conscious that they're testing an offering which is not yet absolutely complete. So I don't think we'd expect to be seeing all of their stockbroking activity at this stage.

Question 4

Sarah Ing, Lazarus

Regarding the stockbroking business, I think it seems it's more driven by the provision of allowing customers to use their stock as collateral, rather than a primary stockbroking offering to begin with. Obviously the stockbroking business perhaps has to evolve out of that. How would the margins differ on clients holding stock versus putting cash with you?

Tim Howkins

That isn't the primary aim, I think it's merely that that is something that will be particularly attractive to our installed client base. New clients are likely to be more active trading on their stockbroking account to start with, and the appeal to us is the ability to cross-sell. The differential in margin between the two is essentially whether or not you earn interest on client money. Clearly if a client has cash with us, then we have the potential to earn interest on that cash, whereas if they have stock with us we don't. However, I'd expect this to be predominantly incremental trading, I wouldn't expect clients to withdraw cash and replace it with stock. We expect this to be incremental to our spread-betting CFD business, not substitutive.

Sarah Ing

In terms of that, would you charge a holding fee for them to hold shares on your platform?

Tim Howkins

No. We're interested primarily in clients who are active traders, and that either means they're actively trading in cash equities on their stockbroking account, or it means they're actively trading spread-betting and CFDs with a slightly more passive stockbroking account. Either is a perfectly good client to us.

<u>Question 5</u>

David Hughes, UBS

I've got two questions. First is, how are you actually discouraging low revenue customers and how do you know they won't become large customers in the future?

And the second one is, if the stockbroking business does well, will you be offering accounts in ISAs and SIPPs, and is there any potential to extend that offering to funds afterwards?

Tim Howkins

In terms of what we did to discourage low value clients, we did talk about this a bit six months ago. We made a number of changes, but the two most significant ones were that we increased the minimum amount you could deposit using a debit card from I think £10 to £100; and we have a client education programme called TradeSense which allows you to trade in small size for your first few weeks. It used to be possible on the FTSE to trade at 10p a point, we raised that to 50p a point. We did this because a lot of analysis of the data over many years showed that there was a kind of cut-off point. If a client started at really, really low levels, and those were things that encouraged them to do really low level trading, then they simply never became valuable because they just didn't have the risk appetite for our sorts of products. So we're very confident that the clients that that has turned off, are not the clients who would have gone on to be valuable over time. Sorry, your second question was?

David Hughes, UBS

Was in relation to extending the offering to ISAs and SIPPs, and then potentially extending the platform to funds.

Tim Howkins

We are intending to offer ISAs or technically I think NISAs, the new ISA, from day one. At this stage we're not planning to offer SIPPs. And as to whether we're going to offer funds, at this stage clearly you can trade ETFs, but we're not planning to offer unit trust type funds. That's obviously something we'll keep under review as we get client feedback, but certainly it won't be part of our initial offering. I think if we were to offer funds then it would be relatively easy to add them as a bolt-on, some sort of white label with a Hargreaves Lansdown or a Fidelity FundsNetwork. I don't think we would add any value by building it ourselves. But as I say, at this stage certainly no intention to do that.

That's it for questions from the lines. Any last questions from the room? In which case, thank you all for coming. Obviously Chris, Kieran and I are available throughout the day if anyone has any further questions.