VALUATION SUMMARY FOR INTERACTIVE BROKERS (IBKR)

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INVESTMENT OVERVIEW

Interactive Brokers (IBKR)

$2 billion market cap but very large insider ownership

Largest electronic brokerage by DART (Daily Average Revenue Trades)

Small hedge funds attracted to it because of its size and stock price "momentum"

Neutral (fairly priced at current levels)

BUSINESS SUMMARY

Market maker and electronic broker founded in the U.S., but active in 21 markets worldwide.

Software company applied to the problem of allowing investors to access capital markets efficiently.

Competes as a low-cost provider. Software tools are sophisticated, appealing to institutional customers (e.g., hedge funds). Increasingly selling its software on a white-label basis to other brokers.

Founded in late 1970s, brokerage business founded in early 1990s, IPO in 2007

The company is 85% owned by its founder through a moderately complex holding company structure.

The company is a highly-efficient “toll booth” that allows access to the capital markets. It’s low prices drive increased traffic and it has significant operational leverage due to its reliance on scalable software.

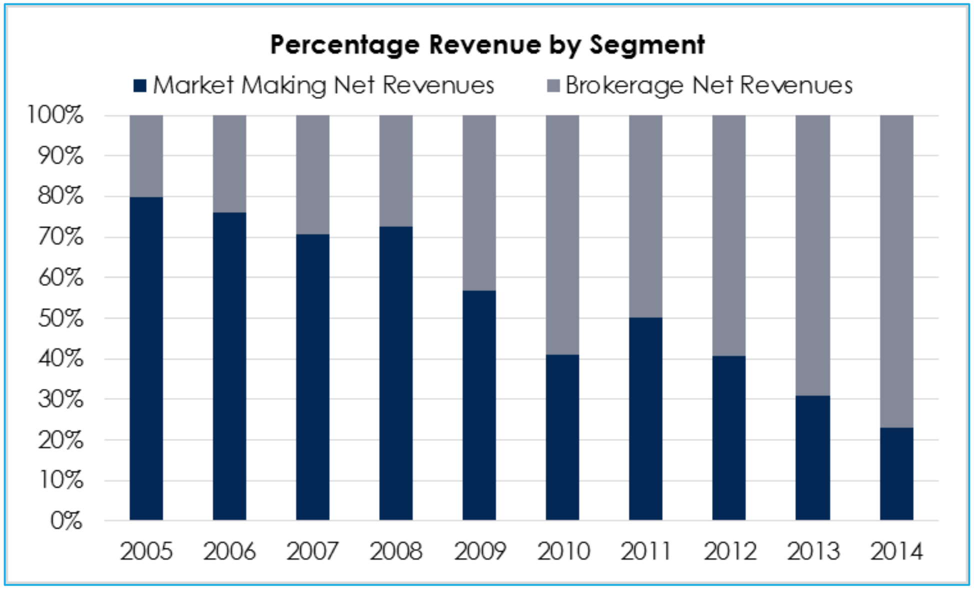
VALUATION DRIVERS

Interactive Brokers

SEGMENT-LEVEL REVENUES

Two segments: Market Making and Electronic Brokerage

The relative importance of these businesses have shifted over time:

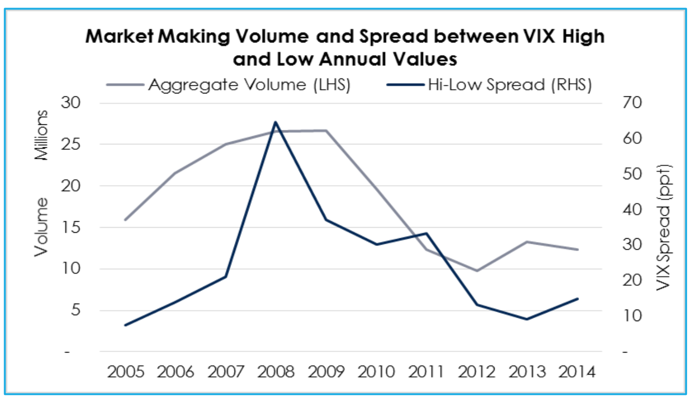


MARKET MAKING REVENUES

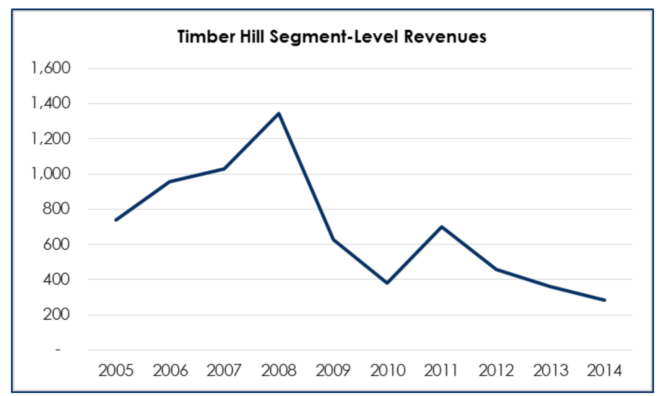
Market Making business is IBKR's old "core" – Timber Hill

Revenues depend on trade volumes and bid-ask spread. Bid-ask spread generally increases as volatility increases.

Business has been hurt also by growth in HFT firms



Low volumes and dropping volatility…



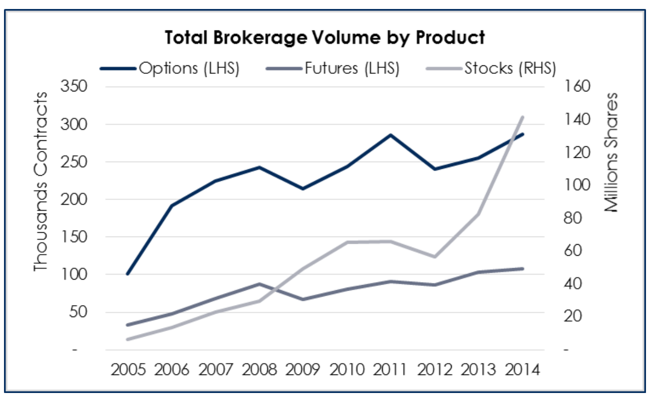
…Have contributed to lower revenues

ELECTRONIC BROKERAGE REVENUES

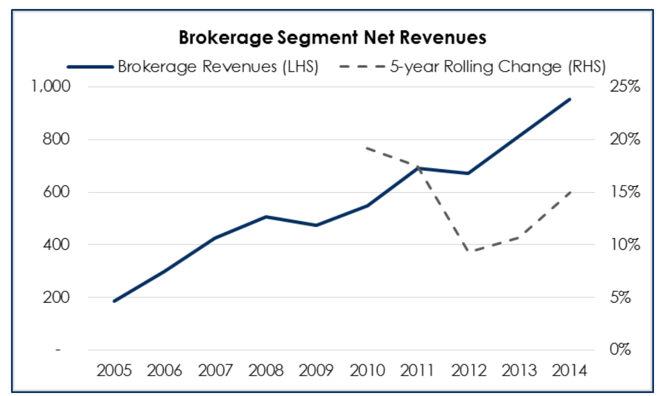
Brokerage is a good business – IBKR's advantage is its automated "STP" trade routing and processing components.

Revenues depend on processed volumes.

Recent boost due to white labeling of components to introducing brokers. IBKR software provides a cheap, efficient bolt on solution to brokerage firms, which can lower internal development and processing costs.



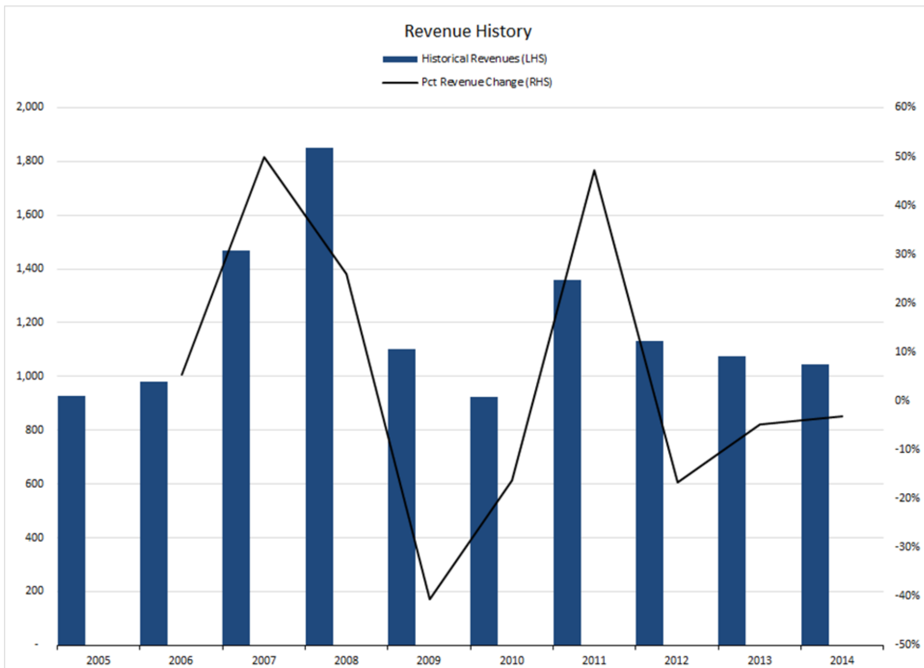
Big uptick in volumes likely due to white labeling



Revenue growth in the mid-teens percent per year

AGGREGATE REVENUES

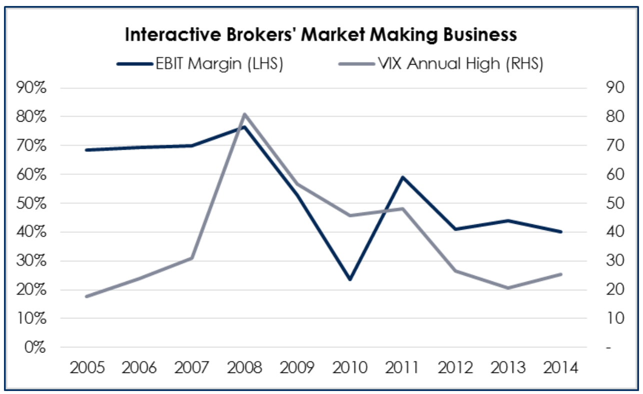
Falling market making revenues have been offset by brokerage revenues.



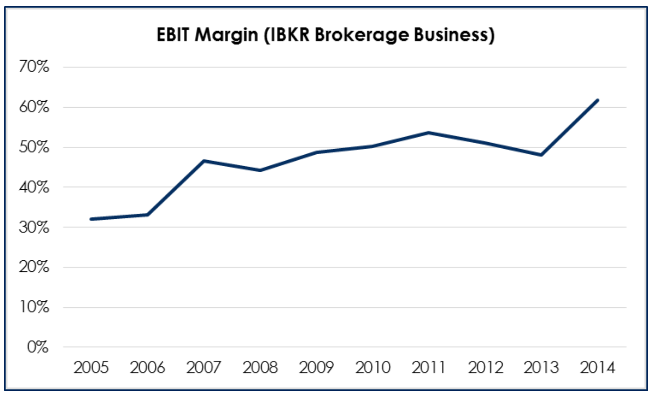
Flat aggregate revenues mask strong demand for brokerage segment

SEGMENT-LEVEL PROFITS

Operating profits in both segments is very high and both show strong operational leverage



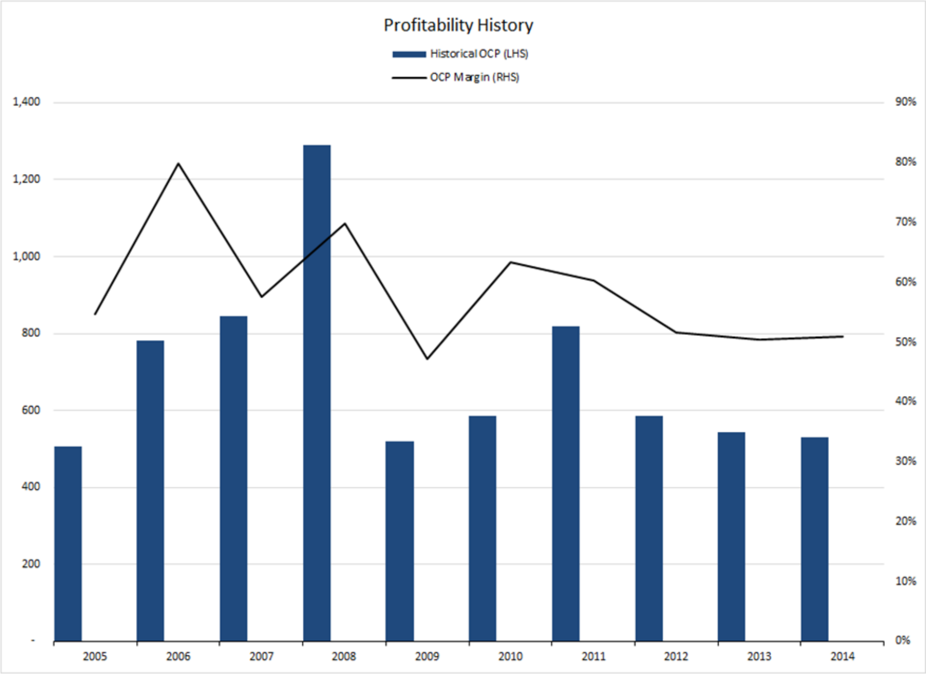
Profits have fallen 19% per year for a 15% fall per year in revenues (5-year CAGR)
Dependency on volatility is clear



Profits have grown 20% per year for a 15% growth per year in revenues (5-year CAGRS)
Dependency on volume is clear

AGGREGATE PROFITS

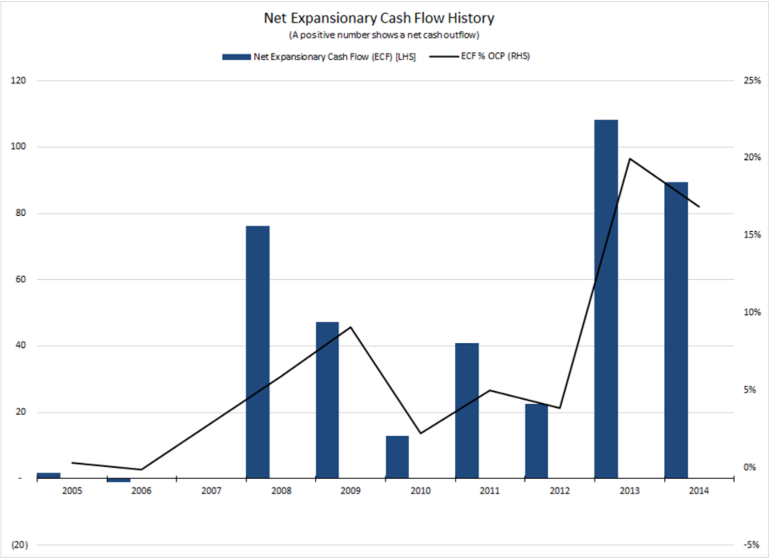
Calculating OCP is made difficult by large fluctuations in working capital. We removed working capital from OCP in our model.

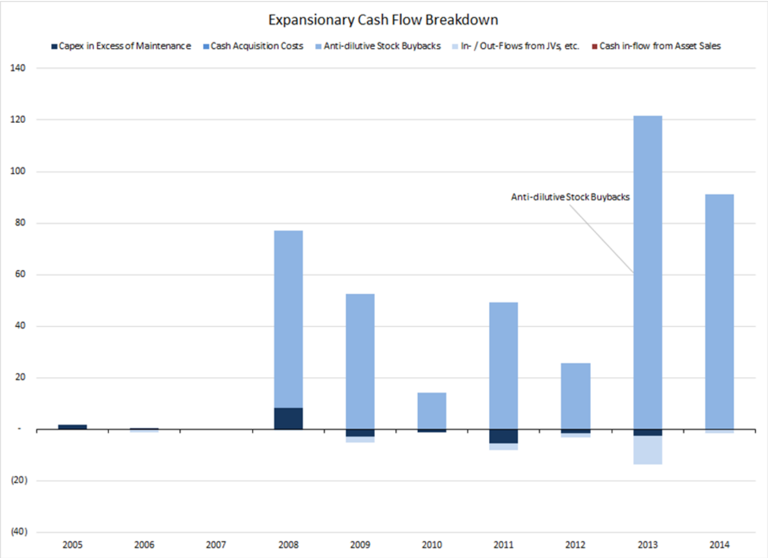


Roughly $0.50 of every revenue dollar flows through to profits!

INVESTMENT LEVEL

Very modest capital spending requirements, as would be expected for a software company.

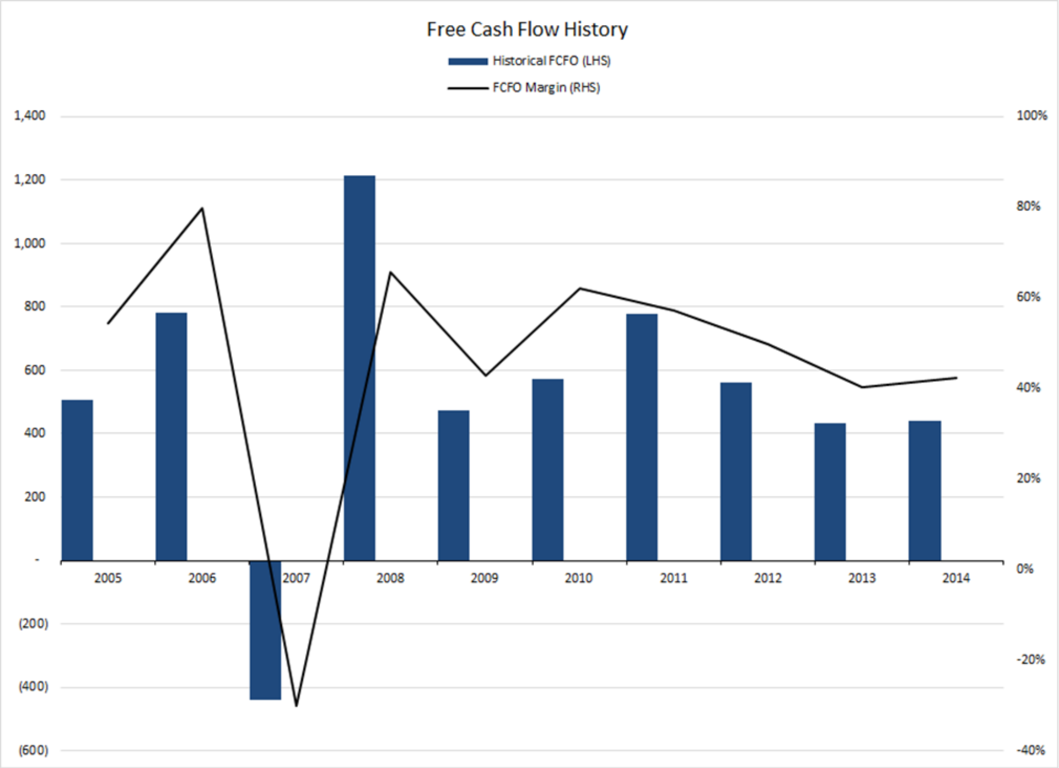




Most ECP due to stock issuance

FREE CASH FLOW TO OWNERS

High profitability combined with low capital spending requirements means that IBKR has a license to print money

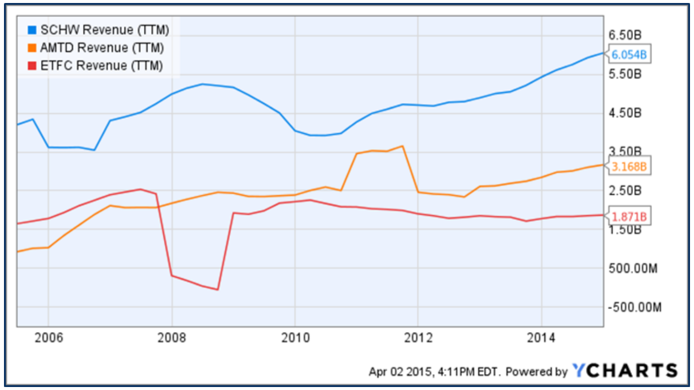


INVESTMENT EFFICACY 1

Efficacy appears low due to drop-off in market making business, but growth of brokerage profits is very high compared to GDP.

Future growth will be constrained by the ability to win new white-label customers on the brokerage side and exogenous factors on the market making side.

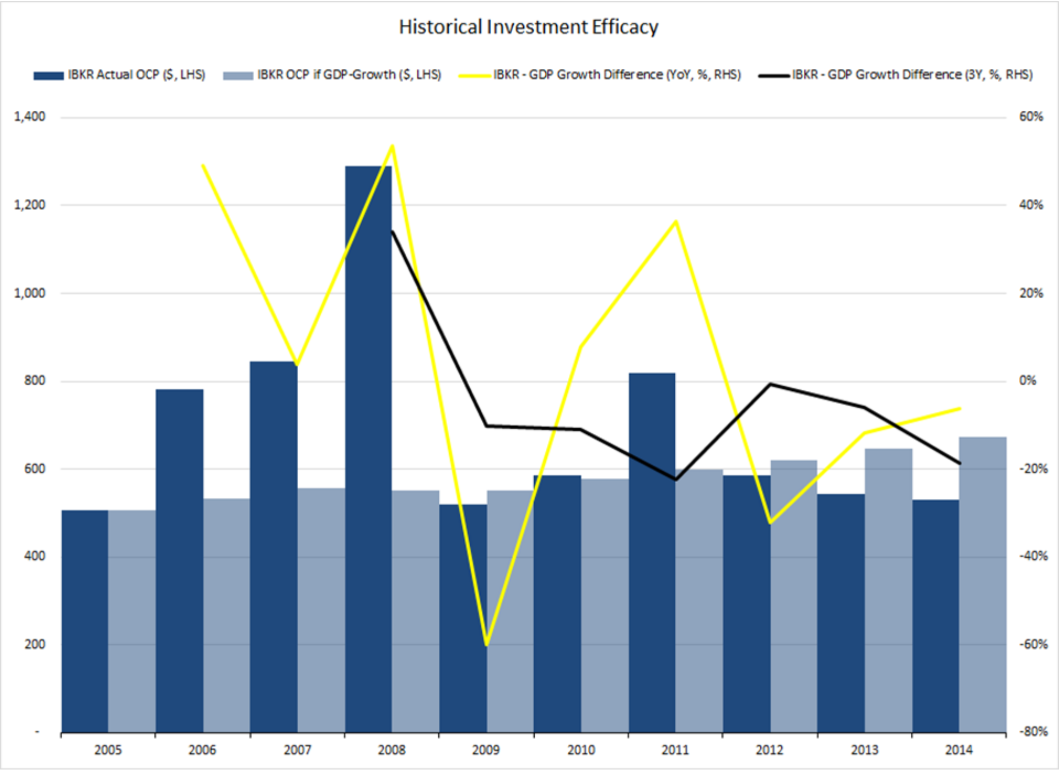
IBKR has won market share from competitors. The industry itself is not a quickly growing one.



Competitors growing revenues in mid-single digit range

INVESTMENT EFFICACY 2

Aggregate efficacy appears low due to factors discussed



BALANCE SHEET EFFECTS

The company has no long-term debt and only very modest short-term debt, so it self-funds its operations. Little risk of liquidity / solvency risk.

Clearly the company's greatest assets are its intellectual property related to trade processing efficiency and the vision of its founder—Peterffy.

Any algorithmic risk control system must have risks, but the company held up well in the mortgage melt-down.