

Interactive Brokers

12 takeaways from CEO's 1st investor group meeting; Maintain Buy & \$139 PO

Reiterate Rating: BUY | PO: 139.00 USD | Price: 89.79 USD

CEO's first group meeting with investors

On Friday, we hosted a group meeting with IBKR's CEO Milan Galik. Galik has been IBKR's CEO since 2019, initially joined the firm in 1992 and helped build IBKR's automated market making systems. Galik is based in Greenwich, CT and runs the firm day-to-day while Chairman Thomas Peterffy is still very active in strategy/decisions. They have worked closely together for the last 33 years. Following the meeting, we maintain our Buy rating and \$139 PO which implies a 55% 12-month total return.

Key takeaways from group meeting with CEO

IBKR is actively evaluating M&A candidates and has no interest in increasing its dividend or repurchasing stock. Additionally, we expect an acceleration in both client activity and total account growth as the economy reaccelerates in 2025 and interest rates fall while the large i-broker win (announced last year) should provide incremental upside to its 20-25% account growth target too. We are not overly concerned with the bear thesis on business mix shift and Fed rate cuts. However, we no longer expect a sizable near-term share opportunity from Thinkorswim integration at SCHW in May. In conclusion, the company understands why its stock is cheap/misvalued and we think they will be more focused on improving its valuation/shareholder ownership going forward.

Maintain Buy: Robust growth and tech R&D advantage

We view IBKR as one of the strongest organic growth names in financial services given its wide product offering (individuals, brokers, hedge funds, mutual funds, prop traders, financial advisors) that it offers globally (>70% of accounts outside of US). Its technology R&D effort allows it to launch more capabilities faster and at lower price points than peers while maintaining its 70% operating margin. (1) We view the IBKR stock as cheap (12x our '25 vs. 17x for SCHW + TW/MKTX at 31-32x), (2) we estimate 15% upside to the 2025 consensus EPS and (3) we believe IBKR will continue to generate strong organic growth (20-25% account growth vs. 3% for SCHW, IBKR grew at 34% average from 2017-22).

Estimates (Dec) (US\$)	2022A	2023A	2024E	2025E	2026E
EPS	4.12	5.69	6.34	6.86	7.97
GAAP EPS	3.75	5.67	6.34	6.86	7.97
EPS Change (YoY)	20.0%	38.2%	11.5%	8.2%	16.2%
Consensus EPS (Bloomberg)			6.26	6.09	6.43
DPS	0.39	0.39	0.39	0.39	0.39
Valuation (Dec)					
P/E	21.8x	15.8x	14.2x	13.1x	11.3x
GAAP P/E	23.9x	15.8x	14.2x	13.1x	11.3x
Dividend Yield	0.4%	0.4%	0.4%	0.4%	0.4%

22 January 2024

Equity

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Stock Data

Price	89.79 USD
Price Objective	139.00 USD
Date Established	16-Jan-2024
Investment Opinion	B-1-7
52-Week Range	70.83 USD -95.59 USD
Mkt Val / Shares Out (mn)	9,609 USD / 107.0
Free Float	95.6%
Average Daily Value	131.96 USD
BofA Ticker / Exchange	IBKR / NAS
Bloomberg / Reuters	IBKR US / IBKR.OQ
ROE (2024E)	0%
ESGMeter™	Medium

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NII: Net interest income
IBKR: Interactive Broker
TW: Tradeweb
MKTX:MarketAxess
SCHW: Charles Schwab

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Timestamp: 22 January 2024 11:56AM EST

iQprofileSM Interactive Brokers

Income Statement Data (Dec)	2022A	2023A	2024E	2025E	2026E
(US\$ Millions)					
Net Revenues	3,067	4,340	4,778	5,178	5,908
Compensation & Benefits	(454)	(527)	(579)	(639)	(697)
% of Net Revenue	14.8%	12.1%	12.1%	12.3%	11.8%
Non-Compensation Expenses	(615)	(743)	(786)	(879)	(993)
Net Income to Ordinary Shareholders	380	601	699	784	943

Balance Sheet Data (Dec)	2022A	2023A	2024E	2025E	2026E
(US\$ Millions)					
Total Assets	115,143	128,423	143,683	161,794	182,361
Deposits	NA	NA	NA	NA	NA
Long Term Debt	0	0	0	0	0
Total Equity	11,615	14,067	16,789	19,880	23,715

Sector Metrics (Dec)	2022A	2023A	2024E	2025E	2026E
(US\$ Millions)					
DARTs	NA	NA	NA	NA	NA
Net Interest Margin	NA	NA	NA	NA	NA
Interest Earning Assets	NA	NA	NA	NA	NA
Net New Assets	NA	NA	NA	NA	NA
Growth	NA	NA	NA	NA	NA
Total Client Assets	NA	NA	NA	NA	NA

Performance Metrics (Dec)	2022A	2023A	2024E	2025E	2026E
(US\$ Millions)					
Operating Margin	65.1%	70.7%	71.4%	70.7%	71.4%
Net Profit Margin	13.6%	13.9%	14.6%	15.1%	16.0%
Comp Expense/Revenue	14.8%	12.1%	12.1%	12.3%	11.8%
Non-Comp Expense / Revenue	20.1%	17.1%	16.5%	17.0%	16.8%
Net Revenue Growth	13.0%	41.5%	10.1%	8.4%	14.1%

Company Sector

Asset Management

Company Description

IBKR is an online broker that provides brokerage services across 135 markets and in 23 different currencies. IBKR offers custody and brokerage services for hedge funds and mutual funds, ETFs, RIAs, proprietary trading groups and individual investors through two different models (IBKR Lite and IBKR Pro).

Investment Rationale

IBKR has the strongest organic growth prospects in our coverage through its broad offering for active traders, retail, brokers, financial advisors, hedge funds and prop traders globally. Its key competitive advantage is its technology R&D effort which supports its first-mover advantages with new capabilities, lower product price points and a 70%+ operating margin.

Quarterly Earnings Estimates

	2023	2024
Q1	1.35A	1.58E
Q2	1.32A	1.60E
Q3	1.55A	1.58E
Q4	1.52A	1.57E

12 takeaways from meeting with CEO

1. IBKR is actively evaluating M&A candidates

On the 4Q23 earnings call, IBKR talked more optimistically about M&A, deploying its excess capital and disclosed that it has been in discussions with two potential candidates. These two deals didn't work out because they couldn't agree on price. The company is targeting smaller online brokers which provide an operating efficiency opportunity in addition to other strategic benefits including geographic and demographic expansions. Gilak noted that >70% of deals in IBKR's industry are not successful and its \$14B balance sheet is important for growth (especially with hedge fund prime business) and risk management (example: Robinhood Markets' capital needs in 1Q21). IBKR's last transaction was in 2020 when it acquired 70,000 self-directed retail customers from Goldman Sachs (formerly the Folio business).

2. Expect acceleration in account growth & client activity

IBKR is currently growing accounts in the middle of its LT target range (20-25%) but we anticipate upside if/when the economy strengthens (BofA economist forecast in 2025) and the current equity bull market extends. This would support stronger organic growth conditions and more robust overall retail engagement. While we don't expect to see retail activity return to 2020-21 levels given the unique circumstances of the COVID pandemic (working from home, fiscal/monetary stimulus, strong bull market) we do view the activity levels of 2022-23 as more of a trough backdrop. This supports our forecast for an acceleration in IBKR's organic growth in addition to stronger trading commissions and higher margin loan balances (all offsets to lower net interest revenues).

3. Big i-broker wins should eventually lift growth too

Last year, IBKR announced two large i-broker (introducing broker) wins. One of the wins was very large with IBKR estimating it at 10% of its total accounts. This win was from a top 10 global bank that is headquartered outside of the US. These accounts will not flow in all at once, but more slowly over several years given that each region will move at a different pace and there are incentives not to be a first mover too. We believe IBKR has learned from this experience and will talk more cautiously about big wins on its earnings calls (or not at all) going forward and also has simplified its customer integration experience in the i-broker channel. An improved onboarding experience could speed up its existing pipeline and also help IBKR continue to win large i-broker relationships.

4. The Bears' concerns on business mix are overdone

A key pushback from the IBKR bears is that IBKR's strong account growth levels will not translate into similar levels of revenue growth due to the underlying mix shift in its business to less profitable and smaller introducing broker accounts. However, in 2023 IBKR's fastest growing segment wasn't introducing broker, it was individual investor which are more profitable. The introducing broker accounts are less profitable from a commission and margin loan standpoint, while their lower cash balances are more accretive on a net interest revenue basis. Additionally, IBKR's 20-25% account growth is very robust and compares to only 2-3% at SCHW which is currently more expensive than IBKR on our 2024-2026 EPS estimates (>30% more expensive on our 2025 EPS). Note: New individual accounts could be trending smaller than existing given that many are coming from Asia and Europe but tough to estimate with IBKR's current disclosures.

5. No interest in share buybacks or dividend increases

Given IBKR's attractive growth prospects, the company would prefer to retain capital for organic growth or use capital for accretive acquisitions. On the 4Q23 earnings call, IBKR talked more openly about M&A and disclosed it was close to finalizing two deals but couldn't agree on price. If IBKR's float wasn't so small relative to its market cap, we think the company could pursue a consistent buyback strategy but share buybacks with the current setup would damage its liquidity and further hurt its ownership. Shareholder ownership is the biggest headwind to IBKR's valuation in our view due to multiple



factors that make it difficult for long-only investors to own. We think IBKR could unlock significant shareholder value by fixing this (similar to what Blackstone and Alternative Investment Managers did from 2016 to date with the C-corp conversions, float expansions and index additions). While IBKR talked more openly about M&A on the 4Q23 earnings call, we don't think there was a big change in its actual M&A strategy.

6. Don't expect sizable NT opportunity from Thinkorswim

Thinkorswim is arguably IBKR's biggest competitor in the active trader market in the US. It was part of Ameritrade and is currently slotted to be integrated into SCHW in May. We thought this would be a near-term opportunity for IBKR to win share given SCHW's weaker brand in the active trader segment but from our conversation with Gilak and others over the last week, we are less confident in this view. Active traders tend to have multiple accounts and rather than close accounts or ACATS (automated customer account transfer service) securities, they tend to pivot activities between accounts and transfer cash. Accordingly, if they are unhappy under SCHW, they would more likely not be as active in these accounts and potentially transfer cash out over time (vs. ACAT and closing the account immediately). SCHW has also not removed any capabilities from Thinkorswim and from conversations with a smaller batch of active traders that were already moved in November, the experience has been fine. SCHW will integrate 1.7M active trader/Thinkorswim customers onto its clearing platform and onto the SCHW app in May while it did a smaller amount in November (November was a mix of normal retail and active traders we estimate).

7. IBKR is upgrading its customer service & usability

Given the global nature of IBKR's business, its customer service centers must operate 24-7 and be prepared to address concerns in many languages. IBKR has invested into digital technologies that provide "self help" which now assist with 30-40% of the incoming requests. Another challenge is IBKR's platform which offers so many capabilities and can be overwhelming to less experienced investors. IBKR is continuing to look for new ways to improve the usability of its platform and could come out with a new offering that offers a more simplified experience too.

8. Offsets to Fed rate cuts support continued EPS growth

IBKR estimates that each 25bps Fed rate cut will reduce its net interest income (NII) by \$56M (per year) and the equivalent non-USD impact would be \$18-20M (IBKR's client cash mix is 75% USD / 25% foreign). However, we see several offsets: (1) higher client activity including trading volumes and margin loan balances; (2) continued strong organic growth (and the impact on interest earning assets as client cash grows); (3) slower expense growth; (4) valuation expansion. We think 1-3 will prevent EPS from declining over the upcoming period of Fed rate cuts while it will temporarily decelerate growth (our EPS growth forecast is 11%/8% in 2024/2025). However, once the Fed rate cuts stop, we expect a sharp reacceleration in EPS growth with higher retail engagement levels on the other side.

9. \$7M in cost saves by 2H24 from Euro consolidation

IBKR previously used its UK affiliate to service all European accounts. However, Brexit created a need to form a 2nd European entity which IBKR initially created in Luxembourg. However, Luxembourg regulators couldn't handle IBKR's size and fast growth and put a cap on its pace of new accounts. IBKR then reacted by creating two entities, in Hungary and Ireland. But then Hungary's rules changed with higher taxation and IBKR no longer needed two entities given that Ireland was working fine. This caused IBKR to decide to close its Hungary operation which will trigger one-time restructuring costs in 2024 which we will exclude from adjusted earnings. This reduction will also drive \$7M in core expense saves which will start flowing through in 3Q24 or 4Q24.

10. Surprised sweep rates not driving more share gains

IBKR is offering 4.83% on client cash balances greater than \$10,000 relative to 45bps at SCHW and lower rates at the big banks. Essentially, IBKR automatically sorts client cash

so the client doesn't have to. With \$38,000 of cash per account, IBKR customers are currently generating \$1,200 of additional annual income versus SCHW customers of similar size (assume all accounts are retail). We believe cash sweep rates have been generating more interest in the RIA (registered investment advisor) segment where SCHW is the industry leader and IBKR is still small but is seeing less inflows via its high cash sweep rates in the retail segment where investors have been less active with sorting their cash.

11. Perspective on why stock is so cheap/misvalued

We think IBKR has been a difficult stock for long-term investors to own given several factors: small float, lack of stock liquidity, visibility into succession-plan, capital retention/intensity, voting control and the buy-side's limited exposure to IBKR's leadership team. Alternatively, given the mostly hedge fund interest on IBKR, we think a bull market or an improvement in these factors could unlock significant valuation upside for the IBKR stock. We believe IBKR and CEO Milan Galik could become more active with investor relations, and this would have a positive impact on its valuation – especially if the broker can improve its long-only and passive ownership and expand its float.

12. Gaining share in hedge fund prime business

IBKR continues to make progress with hedge funds as it was the fastest growing prime broker in 2023. They plan on moving into the number four position in a number of hedge funds served over the near-term (behind Goldman Sachs, Morgan Stanley and JP Morgan). Compared to its rivals, IBKR focuses on smaller hedge funds (<\$50M AuM), but we expect larger wins in the future as IBKR moves upstream given its strong capabilities such as best-ex, inventory of short-able stocks, industry low margin pricing and growing capital base (now \$14B). Hedge fund clients utilize more lucrative products and services (margin loans, derivative trading) than its retail client base. Their retail footprint produces many benefits for their institutional franchise such as a low-cost source of margin funding (cash balances <\$10K which incur a 0% rate) and a large inventory of stocks available for securities lending.

Glossary

GS = Goldman Sachs

I-broker = introducing broker

M&A = mergers and acquisitions

NII = net interest income

NT = near-term

R&D = research and development

RIA = registered investment advisor

Price objective basis & risk

Interactive Brokers (IBKR)

Our price objective (PO) for IBKR is \$139 and is derived from a price to earnings method. We apply a 17.5x multiple to our 2026E EPS to obtain our PO. Our multiple of 17.5x was chosen as we are valuing IBKR off of cyclically peak profits, and compares to the low end of IBKR's historical valuation range (17.5-30x).

Risks to our PO are: changing industry dynamics in China and US regulatory risks with regard to payment for order flow.

Analyst Certification

I, Craig Siegenthaler, CFA, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

US - Brokers, Asset Managers, & Exchanges Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	AllianceBernstein	AB	AB US	Craig Siegenthaler, CFA
	Ameriprise Financial	AMP	AMP US	Craig Siegenthaler, CFA
	Ares Management Corp	ARES	ARES US	Craig Siegenthaler, CFA
	BlackRock, Inc.	BLK	BLK US	Craig Siegenthaler, CFA
	Blackstone	BX	BX US	Craig Siegenthaler, CFA
	Blue Owl Capital	OWL	OWL US	Craig Siegenthaler, CFA
	Cboe Global Markets	CBOE	CBOE US	Craig Siegenthaler, CFA
	Interactive Brokers	IBKR	IBKR US	Craig Siegenthaler, CFA
	Intercontinental Exchange	ICE	ICE US	Craig Siegenthaler, CFA
	KKR & Co. Inc.	KKR	KKR US	Craig Siegenthaler, CFA
	Raymond James Financial	RJF	RJF US	Mark McLaughlin, CFA
	TPG Inc	TPG	TPG US	Craig Siegenthaler, CFA
	Tradeweb Markets Inc.	TW	TW US	Craig Siegenthaler, CFA
	Victory Capital Holdings, Inc.	VCTR	VCTR US	Craig Siegenthaler, CFA
	Virtu Financial	VIRT	VIRT US	Craig Siegenthaler, CFA
NEUTRAL				
	Affiliated Managers Group	AMG	AMG US	Craig Siegenthaler, CFA
	Apollo Global Management	APO	APO US	Craig Siegenthaler, CFA
	Brookfield Asset Management	BAM	BAM US	Craig Siegenthaler, CFA
	CME Group Inc	CME	CME US	Craig Siegenthaler, CFA
	Invesco	IVZ	IVZ US	Craig Siegenthaler, CFA
	Janus Henderson Group	JHG	JHG US	Craig Siegenthaler, CFA
	LPL Financial Holdings	LPLA	LPLA US	Craig Siegenthaler, CFA
	Patria	PAX	PAX US	Craig Siegenthaler, CFA
UNDERPERFORM				
	Charles Schwab Corp.	SCHW	SCHW US	Craig Siegenthaler, CFA
	Franklin Resources	BEN	BEN US	Craig Siegenthaler, CFA
	Nasdaq	NDAQ	NDAQ US	Craig Siegenthaler, CFA
	Robinhood Markets	HOOD	HOOD US	Craig Siegenthaler, CFA
	T. Rowe Price	TROW	TROW US	Craig Siegenthaler, CFA
	The Carlyle Group	CG	CG US	Craig Siegenthaler, CFA



iQmethodSM Measures Definitions

Business Performance

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

EV / EBITDA

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

Basic EBIT + Depreciation + Amortization

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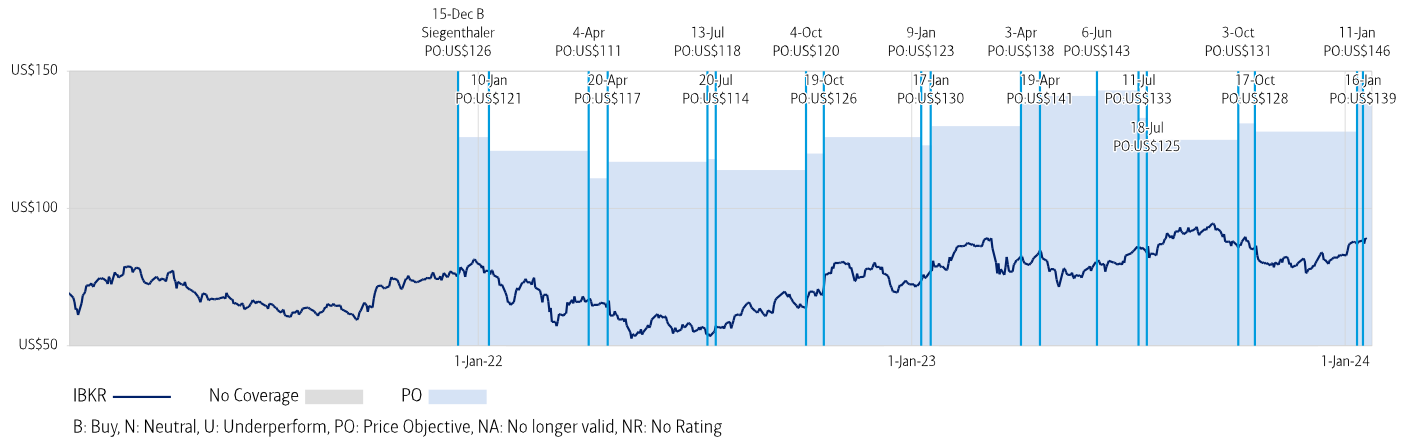
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Interactive Brokers (IBKR) Price Chart



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Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

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