Interactive Brokers Group, Inc. (IBKR)
Q4 2013 Earnings Conference Call
January 21, 2014 4:30 PM ET

Executives
Thomas Peterffy – Chairman, Chief Executive Officer and President
Paul J. Brody – Chief Financial Officer, Treasurer, Secretary
Deborah Liston – Director of Investor Relations

Analysts

Sean Brown – Teton Capital Group, LLC
Richard H. Repetto – Sandler O'Neill & Partners LP
Macrae Sykes – Gabelli & Company, Inc.
Niamh Alexander – Keefe, Bruyette & Woods, Inc.
Fang Li - Baleen Capital Management LLC

Operator

Good day, everyone, and welcome to the Interactive Brokers' Fourth Quarter 2013 Earnings Results Conference Call. This call is being recorded. At this time, for opening remarks and introduction, I would like to turn the call over to Ms. Deborah Liston, Director of Investor Relations. Please go ahead.

Deborah Liston

Thank you, operator and welcome everybody. Hopefully, by now you've seen our fourth quarter earnings release, which was released today after the market closed, and which is also available on our website.

Our speakers today are Thomas Peterffy, our Chairman and CEO and Paul Brody, our Group CFO. Today, we'll start the call with some prepared remarks about the quarter and then we'll take questions.

Today's call may include forward-looking statements, which represent the Company's belief regarding future events and by the nature are not certain and outside the Company's control. Our actual results and financial condition may differ possibly materially from what's indicated in these forward-looking statements. We ask that you refer to the disclaimers in our press release. You should also review a description of the risk factors contained in our financial reports filed with the SEC.

I'd now like to turn the call over to Thomas Peterffy.

Thomas Peterffy

Good afternoon everyone and thanks for joining us to review our fourth quarter performance. We ended 2013 on an upbeat note with strong performance from our Brokerage business which continues to steal the spotlight from the Market Making segment and drive the Company's growth.

Despite the typical seasonal slowdown we would normally see at the end of the year, we added more Brokerage accounts in the fourth quarter than each of the prior three quarters giving further credence to our growth momentum and the ability to outperform our industry peers in the long-term.

This rising trend can be attributed not only to the steady flow of positive word-of-mouth referrals we received from our expanding customer base, but also through the success of our latest initiatives including segment-focused marketing campaigns and our determination to continue bolstering the value of our platform with new technological innovations.

Case in point, in the second half of 2013 we've rolled out a number of exciting new option trading tools that not only complement the extensive suite of tools we currently have, but that further solidify our reputation as the premier broker and the only options broker for the investors who are concerned with execution prices which we know is an important determinant of overall investment performance.

To briefly review the operating environment of the fourth quarter we were pleased to see higher trading volume, driven in part by rising investor confidence, allowing us to record our highest quarterly commissions ever. Persistently low interest rates also encouraged customers to take advantage of our industrial marginal lending rates, which currently range from 0.5% to 1.58% depending upon the size of the loan, driving our margin balances to a record high.

While we witnessed rising volatility levels early in the quarter fueled yet another debt ceiling debate, this spike quickly dissipated and volatility levels settled down throughout the rest of the period.

Before I get into the segment details, let me give you an overall picture of fourth quarter results before any unusual items and currency or tax effects. For the quarter, we reported pretax income of $39 million.   Excluding currency effects and unusual items, it was $144 million composed of $113 million Brokerage and $37 million Market Making and a loss of $6 million in corporate.

For the full year, we reported pretax income of $451 million. The corresponding numbers excluding currency effects and unusual items are $613 million of pretax income comprised of $455 million of Electronic Brokerage and $161 million for Market Making, and a loss of $3 million for corporate. The total per share impact of both the currency effect and the unusual item is a negative $0.16 for the quarter and a negative $0.25 for the – therefore eliminating those, our normalized EPS is about $0.23 this quarter and $0.98 this year.

Now I will explain these items in further detail. The unusual item is a $73 million loss we have reported on our books for the Singapore incident that we discussed – we disclosed in October. As a reminder, certain of our brokerage customers took large positions in a few related stocks listed on the Singapore Stock Exchange last year. In the beginning of the fourth quarter, these stocks lost over 90% of their value in a very short period of time and we are able to liquidate only a small portion for the exchange of the trading.

We are pursuing legal actions to recuperate our loss base and have secured freeze orders in Malaysia and Singapore, but this process will take a long time. We said in October, that the maximum loss would be $84 million. However, because we were able to take the stocks onto our books at a value of about $20 million to offset the margin call, we have a $64 million that has been recorded in bad debt in the Brokerage segment. These stocks have lost about half their value, so we've also recorded a loss of $10 million in the Corporate segment bringing the total impact to $74 million.

As I explained in the last earnings call, this event was an anomaly. Our real-time risk management controls would normally kick in and start liquidating the positions to prevent such a large loss, but in this case our hands were tied because the exchange halted trading almost immediately. So after this loss occurred, we took swift action to modify our margin lending methodology, specifically on stocks that rapidly appreciate in value like these did to prevent similar event in the future.

I will now explain the currency effects that I also excluded from normalized results. As you know we keep our total equity of $5.1 billion in our self defined basket of 16 currencies we call the GLOBAL in order to minimize the currency risk that we would otherwise be exposed to as an internationally diversified firm trading products in 25 different countries.

In the fourth quarter, the value of the GLOBAL declined by half of 1% of the U.S. dollar which resulted in a decrease in our comprehensive earnings for about $25 million, this was $31 million is reflected in trading gains, offsetting gain of $6 million reported below the line in Other Comprehensive Income or OCI.

For the full year, the large swing we saw in translation gain and loss from quarter-to-quarter netted to roughly $116 million decrease is comprehensive earnings due to the strengthening of the U.S. dollar during the year, which equates to about 2% of our total equity capital.

And now I'll review the performance of our Brokerage segment. We achieved many important milestones in 2013. Early in the year we received the distinction for the second year in a row being named the number one Online Broker from Barron's in their annual review of Electronic Brokers with IB scoring highest in several categories including Best International Trading, Best for Frequent Trader, Best Portfolio Analysis Report and having the widest range of offerings. This recognition has boosted our exposure to professional traders, our credibility with institutions and has helped to further expand our customer base.

We added mainly 30,000 customer accounts during the year finished 2013 with 239,000 accounts. This represents a 14% increase year-over-year. We have a diversified customer base with over 40% of our accounts being institutions including hedge and mutual funds and proprietary trading desks, in addition to accounts of independent financial advisors and introducing brokers. The remainder is comprised of individual traders and investors.

Our customer base is also geographically diversified, with our customers residing in nearly 200 countries and over 60% of new accounts coming from outside the United States. The 30,000 newly added accounts are the result of about 60,000 new accounts opening and 30,000 accounts closing.

One of the top reasons why people close accounts is that they are irked by the monthly minimum commission requirement of $10. In any one month in which an account pays less than 10 dollars of commission, we charge them the difference and this seems to anger people to a point as they move their accounts elsewhere and do not recommend us to others.

Bending to popular demand, starting this year we have decided to eliminate this $10 minimum commission requirement for accounts with a net liquidating value over $100,000.

Customer equity has grown to $45.7 billion, a 39% increase over the prior year. Additionally, since they are attracting more institutional accounts, the average equity per customer account has expanded 22% this year to an average of over 190,000 per account.

Our prime brokerage business has taken off since we first started targeting this segment. Today we have over 1,300 hedge fund clients, an increase of 8% over the last year. These funds range from start up managers with a few hundred thousand dollars to larger, multi-billion dollar funds.

The value proposition when comparing IB to the large investment banks is clear. Our customers get superior price execution, since we don't internalize or sell their order flow, but quite the opposite, we invest a great deal of our resources into the maintenance, and further development of our order routing technology to secure the best execution prices for our customers' orders.

In addition, we provide state-of-the-art trading technology, sophisticated algorithms, broad global trading access and securities financing, all of the fraction of the costs charged by these large banks.

Not to mention our Hedge Fund Capital Introduction Program has seen tremendous success since we first launched it in 2011. Of the funds that were participating in IB's Capital Introduction program as of January 1, 2014 and had been in the program for at least three months, approximately 60% of them have been seen at least one investment from an investor through this program.

In addition to Capital Introduction, hedge funds value our premier securities lending and financing.   IB customers not only benefit from our deep inventory of equities available to borrow, but also our very competitive lending rates, and informational tools we provide for locating hard to borrow stocks.

Currently we are able to source about 60% to 75% of borrows internally and we are connected to about 60 counter parties including agents, lenders and brokers for sourcing other hard to borrow items.

Our pre-borrow program give customer the convenience of locating borrows in anticipation of a short sale and helps mitigate the chances of both buy ins and close outs.

As I mentioned earlier, customer margin balances are at a record high, growing 38% this year to $13.5 billion. This has contributed to 25% increase in net interest income over the prior year. Margin as a percentage of customer equity has stayed pretty consistent with about 30%.

In the Brokerage space, one of our biggest advantages over the competition has always been the fact that we are first and foremost the technology firm with emphasis on building systems and applications. As a result, we are constantly working to maximize the value of our platform by actively rolling out new product development, trading tools and tradable products and markets while at the same time keeping our costs at the lowest possible level.

As I mentioned earlier, we have introduced a number of exiting new tools this year, especially focused on option trading. In the fourth quarter, we rolled out the Options Strategy Lab and the Probability Lab, the latter of which have been marketing very heavily through print and television advertisements.

The Options Strategy Lab gives traders the ability to input their price or volatility forecast for any U.S. or a foreign equity into the strategy scanner and receive suggested simple or complex options strategies which can be compared and analyzed based on lowest costs, highest reward to risk ratio, largest gain on lowest maximum loss.

The Probability Lab takes this to the next level by utilizing the same technology and giving the trader a visual tool to think about options trading without complicated mathematics. With the Probability Lab, the trader can view the probability distributions for any U.S. or foreign equity, currency or future contract as implied by the prevailing option prices.

If their opinion of this distribution differs from what the market is implying they can manually adjust the distribution curve and then receive options trade sorted by the highest Sharpe ratio based on that difference. In addition to the marketing efforts I just mentioned, we have also been highlighting valuable uses for the Probability Lab through daily commentary posted by our traders and market participants to the IB Traders' Insight, which, by the way is also a new service we have initiated during the past quarter and which you can access from the homepage of our website.

I believe that with the use of options, we will continue to grow as more and more investors come to understand the benefit of using options as part of building and managing their portfolio. The latest tools we have developed will help our customers find more opportunities to trade options which will in-turn increase our market share and further improve our execution quality beyond the high level we already achieve. I do believe that options are a critical component of our continued success.

Now I will review the performance of our Market Making segment. Market Making pretax profit of $6 million, fell 61% from a year ago quarter and 92% from the prior quarter. However, if we back out the currency effects, we have a clearer picture of our performance. As I mentioned earlier, this period's trading gains were negatively impacted by a translation loss of $31 million. After backing this out, pretax Market Making profits totaled $37 million compared to $46 million in the year ago quarter and $41 million in the prior quarter.

For the full year we reported pretax Market Making profits of $72 million this year compare to $189 million in 2012. After backing out the currency effects, pretax profit of in Market Making were $161 million in 2013 compare to $227 million in 2012.

The environment for Market Making remain tepid with volatility levels remaining at historic lows for much of 2013 and competition remaining strong keeping bid/offer spreads on exchange traded products very narrow. Volatility levels as you know are directly correlated with our Market Making trading gains. The average VIX this quarter totaled 14.2 consistent with the prior year quarter and 15% lower than the year ago quarter.

And when comparing 2013 to 2012 the average VIX was 20% lower, which was a primary driver for the 30% drop in pretax profit. The ratio of actual to implied volatility, which measures our profit captured versus our cost of hedging was 73% this quarter compared to 63% in the prior quarter, 75% in the year ago quarter.

According to data obtained from the exchanges we do business, exchange traded option volume increased 8% in the U.S. but decreased 2% globally for the fourth quarter.

By comparison, our firm's total option volume increased by 1% and as a result our firm's market share was stable at 11.7% in the U.S. and increased from 8.7% to 9% globally. In the Market Making segment alone our option volume decreased by 6% during the fourth quarter, which drove our market share in that segment from 5.9% to 5.5% in the U.S. and from 5.3% to 5.1% globally.

We continue to pay a $0.10 quarterly dividend for Market Making capital. This quarter we earned only about 1% return on equity, far below our 10% hurdle rate and as such we naturally decreased capital in this segment.

We plan to continue monitoring the Market Making environment as we consider our future in this business, but in the meantime we have reduced our participation in less profitable markets and products and have been working to reduce our overhead costs in this segment as well.

Thanks to the strong growth of our Brokerage segment combined with the shrinking of the Market Making segment, total capital in Brokerage has for the first time surpassed that of Market Making. And for 2013 Brokerage comprised over 85% of total pretax profits, but this number is really 75% if you back out the unusual and currency items.

As we begin 2014, we have just launched a next phase our global market place we are building for institutional traders and investors. As you know we already have our Hedge Fund Marketplace also known as our Capital Introduction Program in place as well as our Money Manager marketplace which brings together Wealth Managers and Money Managers.

This month we have also launched our Administrators Marketplace which allows third party administrators, auditors and legal counsel to market their services to hedge funds, advisors and prop trading accounts on our platform as well as have a single login to manage all their IB institutional client accounts they currently service.

Our initiative to create this global marketplace has been very successful thus far in drawing institutions to our platforms and we believe this next step, will be very beneficial to our presence in the hedge fund space.

I will now turn the call over to our CFO Paul Brody who can review the details of the financials.

Paul J. Brody

Thank you Thomas, good afternoon and thanks for joining the call, as usual I'll review our summary results, and then give segment highlights before we take questions. Fourth quarter results shows continuing strength in the brokerage business and tepid earnings in the Market Making segment. As compared to the year ago quarter net revenue for this quarter was driven by rising brokerage commissions and net interest income partially offset by declines in trading gains and a loss on the Singapore stocks event.

Full year results showed similar strength in brokerage and thin Market Making profits further buffeted by adverse currency improvements. Our net pretax profits of $451 million represented a return on average equity of 9% and a profit margin of 42%.

Our financial statements include the GAAP accounting presentation known as "Comprehensive Income". Comprehensive Income reports all currency translation gains and losses, including those that reflect changes in the U.S. dollar value of the Company's non-U.S. subsidiaries (known as Other Comprehensive Income, or "OCI"). These are reported in the Statement of Comprehensive Income.

The performance of the US dollar relative to other currencies was quite mixed in 2013. While certain of the larger components in the currency basket we call the GLOBAL strengthened against the US dollar, a number of other components weakened more than 10% against the dollar. In aggregate the GLOBAL, as expressed in US dollar terms, declined 0.5% for the 4th quarter and 2.4% for the year. OCI is a component of the total GLOBAL effect. Adding OCI to Net Income increased our reported diluted EPS by $0.02 for the quarter and decreased it by $0.06 for the full year.

The unusual loss of about $74mm related to the Singapore stocks impacted EPS by an estimated $0.11.

Overall operating metrics for the latest quarter were mixed. Volumes were up in futures and stocks and down in options vs. the year-ago quarter. Average overall daily trade volume was just over 1 million trades per day, up 16% from the 4th quarter of 2012.

Electronic Brokerage metrics showed solid increases in the number of customer accounts and customer equity. Total and cleared customer DARTs were both up from the year-ago-quarter and sequentially. Orders from cleared customers, who clear and carry their positions and cash with us and contribute more revenue, accounted for 91% of total DARTs, which is holding steady.

Market Making trade volume was unchanged from the prior year quarter, though contract and share volumes were mixed across product types. Other negative metrics, such as low actual-to-implied volatility ratio and losses on our currency diversification strategy, provided continuing headwinds for this segment.

Net revenues were $250 million for the 4th quarter, up 1% from the year-ago-quarter, and $1.08 billion for the full year, down 5% from the prior year.

Trading gains were $44 million for the quarter, negatively impacted by currency translation effects. While trading gains compared to the year-ago-quarter decreased by 31%, excluding the currency translation trading gains would have dropped about 26% from the year-ago results.

Commissions and execution fees were $124 million, up 20%.

Net interest income was $66 million, up 20% from the 4th quarter of 2012. Brokerage produced $60 million and Market Making $7 million, with the remaining small offset in Corporate.

Other income was $16 million, down 38% from the prior year quarter. This primarily reflects additional market data revenue which is paired with increased expenses, offset by losses on non-trading securities related to the Singapore event and recognition of currency translation loss previously reported in OCI.

Non-interest expenses were $211 million, up 40% from the year-ago-quarter, driven by the additional bad debt expense on the Singapore stocks. For the full year, non-interest expenses were up only 4%, as those charges were largely offset by lower variable costs and compensation expenses. Our other fixed operating costs have remained fairly stable.

Within the non-interest expense category, Execution and Clearing expenses were $62 million, up 6% from the year-ago-quarter and generally in line with trading volumes.

Compensation expenses were $57 million, a 12% decrease from the year-ago-quarter. The decrease is, in part, attributable to the non-recurrence of special compensation paid in the prior year. Specifically, a payment was made on unvested shares in our Stock Incentive Plan in lieu of the December 2012 special dividend; and a special one-time grant to employees was made in January 2012.

At December 31 our total headcount was 880, a decrease of 1% from the prior year-end count. Within the operating segments, we continue to add staff in Brokerage and cut back in Market Making.

General & Administrative expenses were $76 million, up 530% from the year-ago quarter, primarily on the Singapore-related bad debt expenses.

As a percentage of net revenues, total non-interest expenses were 84% and out of this number, execution and clearing expense accounted for 25% and compensation expense accounted for 23%. Our fixed expenses were 60% of net revenues.

Pretax income was $39 million, down 60% from the same quarter last year.

For the 4th quarter, our overall pretax profit margin was 16%, as compared to 39% in the year-ago quarter. Brokerage pretax profit margin was 23%, down from 51% in the year-ago quarter due to the Singapore-related loss. Market Making pretax profit margin was 11%, down slightly from 12% in the year-ago quarter.

For the full year, we earned pretax income of $451 million on net revenues of $1.08 billion, down 14% from 2012 when pretax income was $527 million on net revenues of $1.13 billion. For 2013, Brokerage represented 85% of pretax income from the two segments and Market Making represented 15%.

2013 full year overall pretax profit margin was 42%, down from 47% in 2012. For the full year of 2013 pretax profit margins were 48% in Brokerage and 26% in Market Making.

Comprehensive diluted earnings per share were $0.09 for the quarter, as compared to $0.41 for the 4th quarter of 2012. On a non-comprehensive basis, which excludes OCI, diluted earnings per share on net income were $0.07 for the quarter, as compared to $0.19 for the same period in 2012.

For the full year 2013, comprehensive diluted earnings per share were $0.67 vs. $1.13 in 2012. And on a non-comprehensive basis, full year diluted earnings per share were $0.73 vs. $0.89 in 2012.

One other notable impact on EPS is income tax. As reported, diluted earnings per share on comprehensive income for 2012 were $1.13, but there are several items worth mentioning here:

First, a deferred income tax adjustment increased the reported earnings per share on comprehensive income for 2012 by $0.20, as previously disclosed in our Form 10-K for 2012.

Second, during 2012, we restated financial statements from certain prior periods pursuant to an interpretation from the SEC on an issue concerning accounting for noncontrolling interests. One effect of the restatements was a $0.02 increase in EPS for 2012.

Also during 2012 we recognized some tax benefits related to prior years, which boosted EPS by $0.05.

To recap, these tax items increased EPS by $0.27 in 2012. For comparative purposes, the unadjusted diluted earnings per share on a comprehensive basis for 2012 were $0.86.

Turning to the balance sheet. As a result of the growth of our Brokerage business and the withdrawal of capital from our Market Making operations through regular and special dividends, Brokerage now accounts for over 70% of our balance sheet. During 2013, cash and securities segregated for customers rose 7% and secured margin lending to customers rose 38%, while we continued to pare back positions in securities held by our Market Maker units.

According to our announced policy, regular quarterly dividends will continue to temper the capital employed in the Market Making segment. In the 4th quarter our Market Making earnings fell short of the amount needed to fund the dividend, and so capital in that segment was reduced.

Our balance sheet remains highly liquid with low leverage. We actively manage our excess liquidity and we maintain significant borrowing facilities through the securities lending markets and with banks. As a general practice, we hold an amount of cash on hand that provides us with a buffer should we need immediately available funds for any reason. We also continue to maintain over $3 billion in excess regulatory capital in our broker-dealer companies around the world, of which about 62% is in the Brokerage segment.

We continue to carry no long term debt.

Our Consolidated Equity capital at December 31, 2013 was $5.09 billion.

Turning to the segments, beginning with Electronic Brokerage:

Customer trade volumes were up across all product types. Cleared customer options and futures contract volumes were up 34% and 9%, respectively, and stock share volume was up 62% from the year-ago quarter. Customer accounts grew by 14% over the total at year-end 2012 and by 3% in the latest quarter. Total customer DARTS were 499,000 – up 23% from the year-ago-quarter and 6% from the 3rd quarter of 2013. Our cleared customer DARTs, which generate direct revenues for the brokerage business, were 453,000 – up 20% on the year-ago quarter and 6% sequentially. The average number of DARTS per account, on an annualized basis, was 483 – up 6% from the 2012 period and 3% sequentially.

Commission revenue rose on a product mix that featured larger average trade sizes for stocks and futures and smaller for options. This resulted in an overall average cleared commission per DART of $4.23 for the quarter, holding steady with the year-ago quarter and down 2% sequentially.

Customer equity grew to $45.7 billion, up 39% from year-end 2012 and up 10% sequentially. These changes took place during periods in which the S&P 500 index rose 30% over the year and 10% over the last quarter. The source of this growth continues to be a steady inflow of new accounts and customer deposits. Our ability to attract larger customers is reflected in the average account equity, which grew 22% over the year to $191,000.

In addition, our favorable financing rates have allowed us to increase customer margin borrowings. Margin debits continue to build steadily, increasing 38% over the year. Customer credit balances, which increased 23% during 2013, also continue to grow progressively, though spread compression, especially in certain foreign currencies, persists in restraining net interest income.

Higher trade volumes across the product types resulted in top line revenue from commissions and execution fees of $124 million, an increase of 20% over the year-ago quarter and 3% sequentially. These revenues are spread mainly across options, futures, stocks and foreign exchange.

Net interest income rose to $60 million, up 25% from the 4th quarter of 2012. Low benchmark interest rates, which continue to compress the spreads earned by our Brokerage unit, were offset by higher customer credit balances during the year. Our fully-paid Stock Yield Enhancement Program continues to provide an additional source of interest revenue that is shared with our participating customers. As a result, our net interest income rose to 29% of net revenues from 28% in the year-ago quarter.
With a growing customer asset base, we believe we are well positioned to benefit from a rise in interest rates. Based on current balances, we estimate that a general rise in

overnight interest rates of 25 basis points would produce an additional $58 million in net interest income annually. Further increases in rates would produce smaller gains because the interest we pay to our customers is pegged to benchmark rates less a narrow spread.

Execution and clearing fees expenses increased to $46 million for the quarter, up 32% on the year-ago quarter and 24% sequentially, driven by higher trading volume and market data fees.

Fixed expenses increased to $117 million, up 133% on the year-ago quarter, due to the Singapore stock related charges.

Pretax income from electronic brokerage was $49 million for the 4th quarter, down 44% on the year-ago quarter and 55% sequentially. For the full year 2013, pretax income from brokerage was $391 million, up 15% from the prior year.

Looking at the Market making segment, Market Making trade volume was unchanged from the prior year quarter, though mixed across the product types: Options contract volume was down 15%, while futures contract volume and stock share volume were up 33% and 18%, respectively.

Trading gains from market making for the 4th quarter of 2013 were $44 million, down 30% from the year-ago quarter. Currency translation effects negatively impacted the 4th quarter’s reported earnings by $31 million, while the year-ago quarter’s reported earnings were reduced by $38 million.

Our overall equity, as measured in US dollars, was decreased by the strengthening of the US Dollar against certain currencies. More specifically, we measure the overall loss from our strategy of carrying our equity in proportion to the basket of currencies we call the GLOBAL to be about $26 million for the quarter. Because a $6 million translation gain is reported as Other Comprehensive Income, this leaves a loss of $31 million to be included in reported earnings. To summarize this, if we eliminated all currency effects, Pretax Income from market making for the 4th quarter of 2013 would be about $37 million.

Applying the same measures to the full year reveals an overall loss on the GLOBAL of $116 million as compared to a loss of $19 million in 2012. The currency picture was decidedly mixed in 2013: While the dollar weakened against the Swiss franc, Euro, British pound and several smaller currencies, its manifest strengthening against the Australian dollar, Japanese yen, Brazilian real and Indian rupee produced more pronounced effects.

Execution and clearing fees expenses decreased to $17 million for the quarter, down 32% from the year-ago quarter, driven by lower options trading volumes.

Fixed expenses decreased to $30 million, down 23% from the year-ago quarter, as we continue our aggressive expense management in this segment.

Pretax income from market making was $6 million, down 31% from the year-ago quarter without adjusting for OCI. For the full year 2013, pretax income from market making was $72 million, down 62% from the prior year, again, without adjusting for OCI. Taking into account the currency effects from each period, the year-over-year decrease in pretax income from market making would be 20% for the quarter and 29% for the full year.

And now we'll turn the call back over to the moderator and we'll take questions.

Question-and-Answer Session

Operator

Thank you. (Operator Instructions) Our first question comes from the line of Collin Cook from Sandler O'Neill. Mr. Cook your line is open. Would you please press your mute button? It seems he is away from his phone, we can move on.

Our next question comes from the line of Sean Brown from Teton Capital.

Sean Brown – Teton Capital Group, LLC

Hi, guys. Thanks for taking my question. Just real quick, I wanted to focus on Brokerage for a second and just comparing against sort of a watermark Q2 that had very high revenues, so it seems like versus Q2 commission and execution fees are down about $14 million, but on the expense side it doesn't seem like commission and execution and clearing expenses really went down if I heard you correctly and thinking it went up a little bit. And then DARTs are still almost flat versus Q2 maybe down only 1%, but commission and execution fees were down a lot more than that, like 10%. So I am just wondering, puts and takes against a very good high Q2 and so the reasons for I guess revenue shrinking much of the date, commissions revenue shrinking and then expenses not early shrinking that much?

Thomas Peterffy

I'm not sure about what that has to do with – is it the futures? Is it less futures, I think that's overall true with that our futures volume has dissolved over the year. I think that's must be the major cause. No?

Sean Brown – Teton Capital Group, LLC

Got it. So we had sort of strong stocks and a weak futures and it sounds like maybe futures are just like more profitable on a gross profit basis?

Paul J. Brody

Strong stocks and weaker future than the second quarter volume-wise, DARTs-wise, but generally speaking because the exchange fees are so high on future is our gross profit. If one were to just look at the commissions versus the variable cost, the exchange fees, it's well over futures.

Sean Brown – Teton Capital Group, LLC

Right, right. So that's….

Paul J. Brody

That's not telling the whole picture. We have a product mix that contributes to both the revenue stream and the number of DARTs every quarter.

Thomas Peterffy

Also as we get larger accounts, they work their way down the tiered, in other words, our commissions are tiered, so people who very few trades, pay a heck of a lot more than people who do a larger number of trades. It is also true that introducing brokers and financial advisors, we take all their orders together to find their tiers.

So, an introducing broker who has accounts that trade just a few times get a very lower rate because we take all their accounts and we charge them based on the total number of trades that we get from introducing brokers.

Sean Brown – Teton Capital Group, LLC

Got it. So just new one toward larger accounts and sort of increase in account scheme volume discounts, should that continue to sort of adversely impact brokerage gross profit going forward?

Thomas Peterffy

I don't think it adversely impacts gross profit, it reduces the commissions per trade and I very much hope that this trend is going to continue because overall the profits are increasing.

Sean Brown – Teton Capital Group, LLC

Right, right, I guess, what I am looking at is commission and execution fees minus execution and clearing expenses and then some how like on a per share basis or on a per DART basis some combination of that, is that the right way to look at it?

Thomas Peterffy

You see I always look at the total profit, that's what matters to me.

Sean Brown – Teton Capital Group, LLC

Okay, fair enough and then my second question is on the removal of the $10 account minimum fee on I guess, first this was the first that I'd heard that I don't know if you market that at all or not, but do you have plans to market that and so could this sort of be a catalyst for additional market share gains among sort of retail investors that really care about that $10 a month?

Thomas Peterffy

It is surprising it's not so much of the typical retail investor, it's people who are tend to have large accounts and sometimes they sit on positions for a long time and almost they get $10 charge and they say that didn't do any trade, how can you charge me and they can get really angry. And so we collect the information from people who moved their accounts and we ask them why you did that and there is two favorite response results that are changed financial advisors or are don't want to pay the inactivity fee.

Sean Brown – Teton Capital Group, LLC

Got it. So increase net promoter score and more word of mouth hopefully. Last one just quick question. I guess I was surprised that it seems like the average options trade size seem to decline some in the quarter, do you have any notion of why that may have occurred?

Thomas Peterffy

That I have no idea, sorry.

Paul J. Brody

Down a little bit year-over-year, but it's actually fairly consistent with the prior quarter.

Sean Brown – Teton Capital Group, LLC

All right, fair enough, thanks a lot guys.

Operator

Thank you. And our next question comes from the line of Rich Repetto from Sandler O'Neill.

Richard H. Repetto – Sandler O'Neill & Partners LP

Yes hi, good evening Thomas, good evening Paul. My question is on the capital, I know you said 70% is with the broker, but could you go through the equity capital, the exact number at the broker what it was in the prior quarter as well at the market maker?

Paul J. Brody

The 70% number was assets on the balance sheet meaning because the customer business has grown in….

Thomas Peterffy

It's not the capital it's assets.

Richard H. Repetto – Sandler O'Neill & Partners LP

Okay, well good then, can you give me the equity capital of the $5.1 billion, what's at the broker and what's at the Market Making and product that's changed quarter-to-quarter?

Thomas Peterffy

It just flipped, so roughly 51% with the broker and 49% with the market maker.

Richard H. Repetto – Sandler O'Neill & Partners LP

Okay. And 49% of, so it's $2.5 billion, right around $2.5 billion, yes again, it is there well. The next question is, it looks like in the U.S. Thomas you pulled up on a quarter-to-quarter basis the market share pulled back and is that from a more conservative I think you might have mentioned it a little bit, but of a more conservative strategy?

Thomas Peterffy

Well, we keep dropping products and strategies that are very marginal and we feel that it really there is, the profit is not paying for the risk and work, but I must repeat that we are not going to go under the $5 billion capital. So since we are going to continue to carry that amount of capital we may as well do something with it even if it's not giving us as bigger us as big a yield as we would like.

Richard H. Repetto – Sandler O'Neill & Partners LP

Okay. Maybe come back to a question that I started with. Can you just give the change in the capital amount at the market make quarter-to-quarter? I know it declined since you didn't earn the 10%, but it went – you said, once the 49% of the total capital, was it prior?

Thomas Peterffy

Rich, we do not have this number at our fingers. I'm sorry.

Richard H. Repetto – Sandler O'Neill & Partners LP

Okay, okay. And…

Thomas Peterffy

If you call in I'll give it to you, right.

Deborah Liston

We can't give it to one person.

Paul Brody

We haven't released it publicly.

Paul Brody

We pay a dividend every quarter and you know how much it is. It's this $0.10 a share and we disclosed that pre-tax income was about $6 million in marketing.

Richard H. Repetto – Sandler O'Neill & Partners LP

Okay. And I guess very last thing. Is the loss, the $73 million securities loss, I'm just trying to – how that ran through because the SG&A total line was not much more than $73 million. I guess – I'm trying to see the SG&A was $76.2 million. So was there some currency if you normally run at, whatever 14, 12 to 14 SG&A with the $73 million run through and why SG&A only $76 million?

Paul J. Brody

It's a mix of other items that go up and down a little bit every quarter. That's right in the ballpark though.

Richard H. Repetto – Sandler O'Neill & Partners LP

But are we saying that $76 million – $73 million was the trading loss?

Paul J. Brody

$64 million recognized in the brokerage unit at the time we closed the customers out. It's in that line and coming from brokerage. The additional $9 million or $10 million bond taken on the positions that we took over, the we just spoke of earlier, is up in the other income line.

Richard H. Repetto – Sandler O'Neill & Partners LP

Understood, okay. Thank you very much. Thomas and Paul, thank you.

Thomas Peterffy

Thank you, Rich.

Operator

Thank you. Our next question comes from the line of Mac Sykes from Gabelli.

Macrae Sykes – Gabelli & Company, Inc.

Good evening, gentlemen. Congratulation on the progress of prime brokerage. My question is, in terms of conversations with larger hedge funds that are on the traditional investment bank brokerage platforms, what is the value proposition that IBG has at this point given those competitors? Is it access to markets, cheap executions, stock loan, other services, just trying to understand your competitive position with the upper segment given the progress?

Thomas Peterffy

Stock loan is very important, but the most important is that our executions are better. That's the major proposition. Our executions are better, our charges are lower, our stock loan is competitive with Goldman and probably better than anybody else. Our margin rates are equally low if not better. We are not among the 16 banks that according to the paper have still dangerous counterparty credit risk. So, and people often want to have more than one prime broker.

Macrae Sykes – Gabelli & Company, Inc.

You had the terrific execution costs for I mean, it's been, since your existence. Just curious as is it the same sort of a branding issue now with the hedge funds and you're getting more adoption on that in understanding the value proposition there or what are some of the things that going faster?

Thomas Peterffy

We got to keep pushing the name so people know it sooner or later – it's not the institutions we have the problems with, it's the investor in the institutions that still don't know the name and don't recognize it as being as solid as some of the big banks.

Macrae Sykes – Gabelli & Company, Inc.

Then on your margin balances, are there any concentrations, certain products or stocks, we heard from the competitor this morning that they were impacted by having large concentration in Apple earlier last year when their stock sold off they had a kind of material impact on their margin balances, I was just curious if you're seeing any of that or just more pretty diversified in the margin balance?

Thomas Peterffy

Well, we did have some concentration in the most popular stocks that ran off. So, when we instituted these modification to our margin policy we have succeeded in cutting that – those concentrated levels.

Macrae Sykes – Gabelli & Company, Inc.

Okay. Thank you very much sir.

Thomas Peterffy

Thank you.

Operator

Thank you. And our next question comes from the line of Niamh Alexander from KBW.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

Hi, thanks for taking my questions. If I could – start with the brokerage and when we met I think here in the summer and you talked about the next stage of your expansion in addition to kind of from a customer perspective because clearly you were doing a lot on the institutional side, you were thinking about and maybe different regional perspective and go in kind of fully 24/7 maybe to the Middle Eastern markets. Can you expand on may be the progress or the – have you made any decision there or is it something that we should be looking for as a whole new regional expansion why you're introducing brokers in those markets?

Thomas Peterffy

We have….our sales to in the Middle East have risen – we are investigating, but still at the investigation phase of joining some of the Middle Eastern exchanges not as easy as the other areas are, but we have made a decision that we are – and we'll be willing to be open on Sunday – that may be we chose our primary barrier to going into to the Middle East exchanges.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

So that's something that maybe we should expect some more gradual expansion now that you've kind of made the decisions to the 24/7, yeah is there something that we should expect to roll out in the second quarter or is something more gradual through the year?

Thomas Peterffy

Well we're in sensitive negotiations at the moment so I don't really want to say anything further about that.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

Okay, fair enough Thomas and thank you for that. And I guess the other thing is, did you get the comments about not wanting to go below $5 billion in capital and, is there a built-in to that unless the broker that continues to grow as it has which has been quite strong I mean, is there a chance that you would stall the dividend in the market maker because you are not earning it for a awhile so, why the $5 billion number one, why that much for the Group and then if you help me think about potential risk to the dividends?

Thomas Peterffy

Risk to the dividend… there is no risk to the dividend. I can't image a situation which we would not earn the dividend. But if that were to happen then we would go under $5 billion because there is no risk to the dividend.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

Okay then you would in that scenario, but it's just like – it's bulk of for some reason, quarter or something like that and it wasn't offsetting the decline in the market may occur and okay. So why the $5 billion why that level?

Thomas Peterffy

Why $5 billion? Nice round number.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

Big round number.

Thomas Peterffy

It's all people's perception.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

I see. Okay. It's not rating agency or anything like that. You got ton of excess capital.

Thomas Peterffy

That's right.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

Okay, fair enough. And then just lastly, if I can come back to the market maker and you've been persistently pulling back the profitability, it seems that kind of leveled out, if we look at it just per option traded, but is there anything that you are saying kind of you are pulling back from marginal products, but we are seeing it more in terms of bigger volume pull back closer to the market and sequentially. So, is there any kind of step function change we should be looking at or is the kind of the next phase of withdrawal or pull back maybe a particular regional market or is the kind of just more of kind of a grind of incremental marginal product that we should be looking forward?

Thomas Peterffy

We are continuously re-examining almost on a daily basis everything we do in market making and we keep adjusting at the edge.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

Now if volatility picks up and in fact the actual volatility improved after several years of decline, it's something that you could kind of get back into those products relatively quickly if you wanted?

Thomas Peterffy

We could yes.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

Okay, all right, fair enough. I will get back in line. Thanks.

Operator

Thank you. And our next question comes from the line of Fang Li from Baleen Capital.

Fang Li - Baleen Capital Management LLC

Hey guys. Thanks for taking my question.

Yes, I have two questions. My first question is on the brokerage even if you add back the one-time, the $64 million one-time loss from the Singapore customer, it looks like your margins have come down to kind of 53% pretax, whereas in the first couple of quarters of the year you have 56 , 58, 56... Could you talk a little bit about what drove the margin decline there?

Thomas Peterffy

I'm sorry I missed the question. What was the question, Paul?

Paul J. Brody

It is profit margin declined over the quarters in brokerage.

Thomas Peterffy

Yes.

Paul J. Brody

Steadied in after adjusting for the Singapore loss.

Thomas Peterffy

Right.

Paul J. Brody

Those would be 53% versus say 56% or earlier in the year.

Thomas Peterffy

That's say because people are pulling into lower tier commission categories.

Paul J. Brody

Right, per willing and happy to do more business with more overall profit at lower margins

Fang Li – Baleen Capital

Okay, got it.

Thomas Peterffy

And every now and then we open to negotiation.

Fang Li - Baleen Capital Management LLC

Okay, fair. That's helpful. Thanks. The second question I had the $10 fee that you used to charge are no longer are charging, how much revenue did that account for – or does that account for in your historic financials?

Thomas Peterffy

I do not know the answer. I do know that more than 50% – or more than 70% customers have less than $100,000. So it's not… we will continue to be hit by that.

Fang Li - Baleen Capital Management LLC

I see, I see, I see. Okay, thanks for the answer. I appreciate it.

Operator

Thank you. And our next question is a follow-up from the line of Macrae Sykes of Gabelli.

Macrae Sykes – Gabelli & Company, Inc.

Oh just one quick following question, share estimates at the end of the year and then the holding validity percentage ownership.

Paul Brody

I think what is disclosed is the weighted average shares in the quarter and it's in the earnings release.

Macrae Sykes – Gabelli & Company, Inc.

Okay, all right I'll wait for the Q. Thanks.

Operator

All right, our final question is a follow-up from the line of Niamh Alexander from KBW.

Niamh Alexander – Keefe, Bruyette & Woods, Inc.

Hi, thank a lot. Those are the same questions I was just trying to get a sense of the current share count at the end of the quarter because do you have that shell out with the 4.7 and you know, it's bent up a little bit in third quarter, or is there anything you can share little bit? Thank you.

Paul J. Brody

Now wait for the Q, thank you.

Operator

Thank you and that concludes our question-and-answer session for today. Do you have any concluding remarks?

Deborah Liston

No, thanks everyone for participating today. And just a reminder this call will be available on replay on our website and we'll be posting a clean version of our transcript on the website tomorrow. Thanks again for your time.

Operator

Ladies and gentlemen, thank you for your participation in today's conference. This does conclude the program and you may now disconnect. Everyone have a good day.