

Interactive Brokers Group, Inc.  
Form 10-Q  
November 10, 2008

## UNITED STATES

## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

---

## FORM 10-Q

---

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2008.

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-33440

## INTERACTIVE BROKERS GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction  
of incorporation or organization)

30-0390693  
(I.R.S. Employer  
Identification No.)

One Pickwick Plaza

Greenwich, Connecticut 06830

(Address of principal executive office)

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

(203) 618-5800

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No .

As of November 10, 2008, there were 40,612,415 shares of the issuer's Class A common stock, par value \$0.01 per share, outstanding and 100 shares of the issuer's Class B common stock, par value \$0.01 per share, outstanding.

---

INTERACTIVE BROKERS GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q FOR THE QUARTER ENDED SEPTEMBER 30, 2008

## Table of Contents

	Page
<b>PART I: FINANCIAL INFORMATION</b>	
<b>Item 1:</b>	<b>Financial Statements (Unaudited)</b> 2
	Condensed Consolidated Statements of Financial Condition 3
	Condensed Consolidated Statements of Income 4
	Condensed Consolidated Statements of Cash Flows (As Restated) 5
	Condensed Consolidated Statement of Changes in Stockholders' Equity 6
	Notes to Condensed Consolidated Financial Statements 7
<b>Item 2:</b>	<b>Management's Discussion and Analysis of Financial Condition and Results of Operations</b> 25
<b>Item 3:</b>	<b>Quantitative and Qualitative Disclosures About Market Risk</b> 47
<b>Item 4:</b>	<b>Controls and Procedures</b> 49
<b>PART II: OTHER INFORMATION</b>	
<b>Item 1:</b>	<b>Legal Proceedings</b> 50
<b>Item 1A:</b>	<b>Risk Factors</b> 50
<b>Item 2:</b>	<b>Unregistered Sales of Equity Securities and Use of Proceeds</b> 50
<b>Item 3:</b>	<b>Defaults upon Senior Securities</b> 50
<b>Item 4:</b>	<b>Submission of Matters to a Vote of Security Holders</b> 50
<b>Item 5:</b>	<b>Other Information</b> 51
<b>Item 6:</b>	<b>Exhibits</b> 52
<b>SIGNATURES</b>	53



## PART I: FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS (UNAUDITED)

#### Financial Statements Introductory Note

Interactive Brokers Group, Inc. (“IBG, Inc.” or the “Company”) is a holding company whose primary asset is its ownership of approximately 10.4% of the membership interests of IBG LLC (the “Group”).

We are an automated global electronic market maker and broker specializing in routing orders and executing and processing trades in securities, futures and foreign exchange instruments on more than 70 electronic exchanges and trading venues around the world. In the U.S., our business is conducted from our headquarters in Greenwich, Connecticut as well as from Chicago, Illinois and Lake Forest, California. Abroad, we conduct business through offices located in Canada, England, Switzerland, Hong Kong, India and Australia. At September 30, 2008 we had 730 employees worldwide.

On May 3, 2007, IBG, Inc. priced its initial public offering (the “IPO”) of shares of its Class A common stock, par value \$0.01 per share (the “Common Stock”). In connection with the IPO, IBG, Inc. purchased 10.0% of the membership interests in IBG LLC, and became the sole managing member of IBG LLC, the holding company for our businesses, and began to consolidate IBG LLC’s financial results into its financial statements. When we use the terms “we,” “us,” and “our,” we mean IBG LLC and its subsidiaries for periods prior to the IPO, and IBG, Inc. and its subsidiaries (including IBG LLC) for periods from and after the IPO. Such transactions, collectively referred to herein as the “Recapitalization,” are described in greater detail in Note 4 to the unaudited condensed consolidated financial statements. Unless otherwise indicated, the term “common stock” refers to the Class A common stock of IBG, Inc.

The unaudited condensed consolidated financial statements as of and for the three and nine month periods ended September 30, 2008 and the unaudited condensed consolidated statement of financial condition as of December 31, 2007 reflect IBG, Inc. and its subsidiaries. The unaudited condensed consolidated statements of income and of cash flows (as restated) for the interim periods ended September 30, 2007 presented reflect the historical results of operations of IBG, Inc., including consolidation of its investment in IBG LLC subsequent to the May 4, 2007 IPO. Prior to May 4, 2007, the unaudited condensed consolidated financial statements included herein represent the financial statements of IBG LLC and its subsidiaries.

The unaudited condensed consolidated financial statements do not reflect what the financial position, results of operations or cash flows of IBG, Inc. or the Group would have been had these companies been stand-alone public companies prior to May 4, 2007. Specifically, the historical financial statements of the Group do not give effect to the following matters:

- the Recapitalization;
- U.S. corporate federal income taxes; and
- minority interest held by IBG Holdings LLC.

As a consequence, earnings per share information reported in the unaudited condensed consolidated statements of income reflect only net income available for common stockholders for the period subsequent to May 3, 2007, as detailed in Note 4 to the unaudited condensed consolidated financial statements.

**Interactive Brokers Group, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Financial Condition**  
**(Unaudited)**

(in thousands, except share data)	September 30, 2008	December 31, 2007
<b>Assets</b>		
Cash and cash equivalents	\$ 471,048	\$ 521,776
Cash and securities - segregated for regulatory purposes	5,276,629	5,232,557
Securities borrowed	4,705,891	6,862,028
Securities purchased under agreements to resell	412,154	35,001
Trading assets, at fair value:		
Financial instruments owned	10,984,746	11,018,613
Financial instruments owned and pledged as collateral	2,750,618	5,838,900
	13,735,364	16,857,513
Other receivables:		
Customers, less allowance for doubtful accounts of \$5,751 and \$1,999 at September 30, 2008 and December 31, 2007	1,919,989	1,916,076
Brokers, dealers and clearing organizations	2,253,138	2,484,163
Receivable from affiliate	5,864	--
Interest	53,733	85,478
	4,232,724	4,485,717
Other assets	517,867	547,494
<b>Total assets</b>	<b>\$ 29,351,677</b>	<b>\$ 34,542,086</b>
<b>Liabilities and stockholders' equity</b>		
Liabilities:		
Trading liabilities - financial instruments sold but not yet purchased, at fair value	\$ 11,400,133	\$ 14,315,853
Securities loaned	2,230,558	4,968,863
Short-term borrowings	940,740	1,415,725
Other payables:		
Customers	6,997,910	7,630,703
Brokers, dealers and clearing organizations	2,532,816	1,568,620
Payable to affiliate	323,698	323,901
Accounts payable, accrued expenses and other liabilities	267,022	231,008
Interest	37,457	53,133
	10,158,903	9,807,365
Senior notes payable	181,719	160,456
Senior secured credit facility	300,000	300,000
Minority interest	3,647,451	3,165,421
<b>Commitments, contingencies and guarantees</b>		
Stockholders' equity:		
Common stock, \$0.01 par value per share		
Class A – Authorized- 1,000,000,000, Issued- 43,270,823, Outstanding– 40,602,415 and 40,143,760 at September 30, 2008 and December 31, 2007	433	433
Class B – Authorized, Issued and Outstanding – 100 at September 30, 2008 and December 31, 2007	--	--
Additional paid-in capital	450,667	450,667
Retained earnings	120,846	48,160
Accumulated other comprehensive income, net of income taxes of \$761 and \$2,388 at September 30, 2008 and December 31, 2007	1,312	4,109
Treasury stock, at cost, 2,668,408 and 3,127,063 shares at September 30, 2008 and December 31, 2007	(81,085)	(94,966)
Total stockholders' equity	492,173	408,403
<b>Total liabilities and stockholders' equity</b>	<b>\$ 29,351,677</b>	<b>\$ 34,542,086</b>

See accompanying notes to the unaudited condensed consolidated financial statements.

**Interactive Brokers Group, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Income**  
**(Unaudited)**

(in thousands, except for shares or per share amounts)	Three months ended September 30,		Nine months ended September 30,	
	2008	2007	2008	2007
<b>Revenues:</b>				
Trading gains	\$ 361,403	\$ 289,226	\$ 1,006,007	\$ 638,327
Commissions and execution fees	98,114	69,490	271,851	186,110
Interest income	101,168	207,547	373,818	597,157
Other income	7,129	21,610	55,645	68,903
Total revenues	567,814	587,873	1,707,321	1,490,497
<b>Interest expense</b>				
Interest expense	70,819	142,720	286,502	419,803
Total net revenues	496,995	445,153	1,420,819	1,070,694
<b>Non-interest expenses:</b>				
Execution and clearing	82,912	85,171	244,044	256,665
Employee compensation and benefits	39,549	30,993	119,425	92,667
Occupancy, depreciation and amortization	10,506	6,706	27,647	19,124
Communications	4,769	4,055	13,339	10,990
General and administrative	11,869	10,363	35,660	28,392
Total non-interest expenses	149,605	137,288	440,115	407,838
Income before income taxes and minority interest	347,390	307,865	980,704	662,856
Income tax expense	32,384	27,228	94,390	38,875
Minority interest subsequent to May 3, 2007	287,859	258,394	813,628	342,400
Net income	\$ 27,147	\$ 22,243	\$ 72,686	\$ 281,581
Net income and earnings per share for periods subsequent to May 3, 2007 (Note 4):				
Net income available for common stockholders	\$ 27,147	\$ 22,243	\$ 72,686	\$ 29,249
<b>Earnings per share:</b>				
Basic	\$ 0.67	\$ 0.55	\$ 1.80	\$ 0.73
Diluted	\$ 0.65	\$ 0.53	\$ 1.76	\$ 0.69
<b>Weighted average common shares outstanding:</b>				
Basic	40,602,515	40,142,196	40,386,579	40,159,927
Diluted	399,112,085	401,315,481	400,180,439	401,334,128

See accompanying notes to the unaudited condensed consolidated financial statements.



**Interactive Brokers Group, Inc. and Subsidiaries**  
**Condensed Consolidated Statements of Cash Flows**  
**(Unaudited)**

(in thousands)	Nine months ended September 30,	
	2008	2007
Cash flows from operating activities:		(As Restated - See Note 11)
Net income	\$ 72,686	\$ 281,581
Adjustments to reconcile net income to net cash provided by operating activities:		
Translation gains	(8,470)	(43,084)
Deferred income taxes	46,942	15,360
Depreciation and amortization	13,114	8,954
Minority interest	813,628	342,400
Employee stock plan compensation	20,655	10,987
Losses (gains) on non-trading investments, net	14,136	(1,166)
Other	4,037	1,781
Change in operating assets and liabilities:		
Increase in cash and securities - segregated for regulatory purposes	(44,029)	(1,602,472)
Decrease in securities borrowed	2,160,597	1,252,679
(Increase) decrease in securities purchased under agreements to resell	(377,154)	97,740
Decrease (increase) in trading assets	3,144,000	(1,217,802)
Increase in receivables from customers	(3,675)	(472,347)
Decrease (increase) in other receivables	264,940	(1,665,368)
Decrease (increase) in other assets	9,305	(6,342)
(Decrease) increase in trading liabilities	(2,896,702)	3,091,548
Decrease in securities loaned	(2,736,842)	(2,962,971)
(Decrease) increase in payable to customers	(631,965)	2,528,825
Increase in other payables	934,983	545,225
Net cash provided by operating activities	800,186	205,528
Cash flows from investing activities:		
Sale (purchase) of investments	610	(9,941)
Purchase of IBG LLC historical member interests	--	(1,177,892)
Purchase of trading rights	--	(750)
Purchase of property and equipment	(11,235)	(12,007)
Net cash used in investing activities	(10,625)	(1,200,590)
Cash flows from financing activities:		
Net proceeds from issuance of Class A and Class B Common Stock	--	1,177,392
Class A Common Stock acquired from employees	--	(1,376)
Redemption of member interests from IBG Holdings LLC	(72,015)	--
Dividends paid by IBG LLC prior to IPO	--	(158,500)
Dividends paid to IBG Holdings LLC subsequent to IPO	(222,776)	(102,431)
Cash capital contribution to THE	--	37,000
Issuances of senior notes	382,711	341,716
Redemptions of senior notes	(361,448)	(337,397)
Borrowings under senior secured credit facility	550,000	62,000
Repayments of senior secured credit facility	(550,000)	--
Decrease in short-term borrowings, net	(533,560)	(220,414)
Net cash (used in) provided by financing activities	(807,088)	797,990
Effect of exchange rate changes on cash and cash equivalents	(33,201)	28,611
Net decrease in cash and cash equivalents	(50,728)	(168,461)
Cash and cash equivalents at beginning of period	521,776	669,271
Cash and cash equivalents at end of period	\$ 471,048	\$ 500,810
Supplemental disclosures of cash flow information:		
IPO related transactions (Note 4):		
Deferred tax asset arising from IPO	\$ --	\$ 380,785
Payable to affiliate	--	323,668
Net tax benefit retained, recorded as additional paid in capital	\$ --	\$ 57,117
Cash paid for interest	\$ 302,178	\$ 422,015

**Interactive Brokers Group, Inc. and Subsidiaries**

Cash paid for taxes	\$ 78,292	\$ 3,489
Non-cash investing activities:		
Refinancing of bridge loan	\$ --	\$ 10,018

See accompanying notes to the unaudited condensed consolidated financial statements.

**Interactive Brokers Group, Inc. and Subsidiaries**  
**Condensed Consolidated Statement of Changes in Stockholders' Equity**  
**Interactive Brokers Group, Inc. and Subsidiaries**  
**Nine months ended September 30, 2008**  
**(Unaudited)**

(in thousands, except for share amounts)

	Common Stock		Additional		Retained	Accumulated	Total
	Shares	Par Value	Paid-In Capital	Treasury Stock	Earnings	Other Comprehensive Income	Stockholders' Equity
Balance, January 1, 2008	40,143,860	\$ 433	\$ 450,667	(\$94,966)	\$ 48,160	\$ 4,109	\$ 408,403
Common Stock distributed to employees	458,655			13,881			13,881
<b>Comprehensive income:</b>							
Net income					\$ 72,686		72,686
Cumulative translation adjustment, net of income taxes of (\$1,626)						(2,797)	(2,797)
<b>Total comprehensive income</b>					<b>72,686</b>	<b>(2,797)</b>	<b>69,889</b>
Balance, September 30, 2008	40,602,515	\$ 433	\$ 450,667	(\$81,085)	\$ 120,846	\$ 1,312	\$ 492,173

See accompanying notes to the unaudited condensed consolidated financial statements.

## Interactive Brokers Group, Inc. and Subsidiaries

### Notes to Unaudited Condensed Consolidated Financial Statements

(dollars in thousands, except shares and per share amounts, unless otherwise noted)

#### 1. Organization and Nature of Business

Interactive Brokers Group, Inc. ("IBG, Inc." or the "Company") is a Delaware holding company whose primary asset is its ownership of approximately 10.4% of the membership interests of IBG LLC, which, in turn, owns all operating subsidiaries (collectively, "IBG LLC" or the "Group"). At September 30, 2008 IBG LLC had equity capital in the form of redeemable members' interests of \$4,082,192. For the three and nine month periods ended September 30, 2008, IBG LLC earned net income of \$321,310 and \$907,500, respectively. Approximately 10.4% of IBG LLC's equity capital and earnings was allocated to IBG, Inc. and the remainder was allocated to minority interest.

The accompanying unaudited condensed consolidated financial statements of IBG, Inc. include the financial results of IBG LLC for the periods reported. Subsequent to May 3, 2007, the statements reflect the consolidation of IBG, Inc.'s investment in IBG LLC. On May 9, 2007, IBG, Inc. issued 40 million shares of its Class A common stock pursuant to a registered public offering (the "IPO", see Note 4), completed its purchase of a 10.0% interest in IBG LLC and became the sole managing member of the Group under the "Amended and Restated Operating Agreement of IBG LLC" dated May 3, 2007. IBG, Inc.'s primary operating asset is its ownership interest in IBG LLC. IBG LLC is an automated global market maker and electronic broker specializing in routing orders and processing trades in securities, futures and foreign exchange instruments.

IBG LLC is a Connecticut limited liability company that conducts its business through its operating subsidiaries (collectively called the "Operating Companies"): Timber Hill LLC ("TH LLC"), Timber Hill Europe AG ("THE"), Timber Hill Securities Hong Kong Limited ("THSHK"), Timber Hill Australia Pty Limited ("THA"), Timber Hill Canada Company ("THC"), Interactive Brokers LLC ("IB LLC"), Interactive Brokers Canada Inc. ("IBC"), Interactive Brokers (U.K.) Limited ("IBUK"), Interactive Brokers (India) Private Limited ("IBI"), Interactive Brokers Hungary KFT ("IBH"), IB Exchange Corp. ("IBEC") and FutureTrade Technologies, LLC and subsidiaries ("FTT").

The Operating Companies are members of various securities and commodities exchanges in North America, Europe and the Asia/Pacific region. Other than IB LLC, IBUK and IBC, the Operating Companies do not carry securities accounts for customers or perform custodial functions relating to customer securities.

#### 2. Significant Accounting Policies

##### *Basis of Presentation*

These unaudited condensed consolidated financial statements are presented in U.S. dollars and have been prepared pursuant to the rules and regulations of the U.S. Securities and Exchange Commission ("SEC") regarding interim financial reporting with respect to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America ("U.S. GAAP") for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in IBG, Inc.'s Annual Report on Form 10-K filed with the SEC on March 27, 2008.

The unaudited condensed consolidated financial statements as of and for the three and nine month periods ended September 30, 2008 and the unaudited condensed consolidated statement of financial condition as of December 31, 2007 reflect IBG, Inc. and its subsidiaries.

The unaudited condensed consolidated statements of income and of cash flows (as restated) for the interim periods ended September 30, 2007 presented reflect the historical results of operations of IBG, Inc., including consolidation of its investment in IBG LLC subsequent to the May 4,

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

2007 IPO. Prior to May 4, 2007, the unaudited condensed consolidated financial statements included herein represent the financial statements of IBG LLC.

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

The unaudited condensed consolidated financial statements do not reflect what the financial position, results of operations or cash flows of IBG, Inc. or the Group would have been had these companies been stand-alone public companies prior to May 4, 2007. Specifically, the historical financial statements of the Group do not give effect to the following matters:

- the Recapitalization;
- U.S. corporate federal income taxes; and
- minority interest held by IBG Holdings LLC.

In management's opinion, the unaudited condensed consolidated financial statements reflect all normal recurring adjustments to present fairly IBG, Inc.'s financial position, results of operations and cash flows for the interim periods presented. The unaudited condensed consolidated results of operations and of cash flows for the interim periods ended September 30, 2008 presented are not necessarily indicative of the results to be expected for any future period or for the full year.

***Principles of Consolidation***

The unaudited condensed consolidated financial statements include the accounts of IBG, Inc. and its majority and wholly owned subsidiaries. As sole managing member of IBG LLC, IBG, Inc. exerts control over the Group's operations. In accordance with Accounting Research Bulletin No. 51, "Consolidated Financial Statements," and SFAS No. 94, "Consolidation of All Majority-Owned Subsidiaries," the Company consolidates the Group's consolidated financial statements and records as minority interest the interests in the Group that IBG, Inc. does not own. The Company's policy is to consolidate all entities of which it owns more than 50% unless it does not have control. All inter-company balances and transactions have been eliminated.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures in the unaudited condensed consolidated financial statements and accompanying notes. Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ materially from those estimates. Such estimates include the estimated fair value of investments accounted for under the equity method of accounting, the estimated useful lives of property and equipment, including capitalized internally developed software, the allowance for doubtful accounts, compensation accruals, tax liabilities and estimated contingency reserves.

***Fair Value***

IBG, Inc. adopted Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements" as of January 1, 2008. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The three levels of the fair value hierarchy under SFAS No. 157 are:

- |         |  |
|---------|--|
| Level 1 | Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;                                  |
| Level 2 | Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly; and |

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

Level 3      Prices or valuations that require inputs that are both significant to fair value measurement and unobservable

In determining fair value, financial instruments owned and financial instruments sold, but not yet purchased, except forward currency contracts, which are classified as Level 2 financial instruments, are classified within Level 1 of the fair value hierarchy. Level 1 financial instruments, which are valued using quoted market prices as published by exchanges and

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

clearing houses or otherwise broadly distributed in active markets, include U.S. government and sovereign obligations, active listed securities, options, futures, options on futures and corporate debt securities. IBG, Inc. does not adjust quoted prices for Level 1 financial instruments, even in the event that the Company may hold a large position whereby a purchase or sale could reasonably impact quoted prices. Currency forward contracts are classified as Level 2 financial instruments as such instruments are not exchange-traded.

IBG, Inc. also adopted SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115" as of January 1, 2008. SFAS No. 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. At adoption, the Company had no assets or liabilities for which it elected the fair value option.

***Earnings Per Share***

Earnings per share ("EPS") is computed in accordance with SFAS No. 128, "Earnings Per Share." Shares of Class A and Class B common stock share proportionately in the earnings of IBG, Inc. Basic earnings per share are calculated utilizing net income available for common stockholders for the three and nine month periods ended September 30, 2008, divided by the weighted average number of shares of Class A and Class B common stock outstanding. Diluted earnings per share are calculated utilizing net income available for common stockholders divided by the weighted average percentage of IBG LLC interests owned by IBG, Inc. during the period to arrive at an amount of net income that would be available for common stockholders on a fully-diluted basis if all member interests in IBG LLC currently held by IBG Holdings LLC had been sold to IBG, Inc. and an equivalent number of shares of Common Stock had been issued by IBG, Inc. This resulting net income is divided by the weighted average total number of shares of Class A and Class B common stock that would be outstanding if such a transaction had occurred, and includes shares of Common Stock issued and issuable under the 2007 ROI Unit Stock Plan and shares of Common Stock issued under the 2007 Stock Incentive Plan (Note 5).

***Stock-Based Compensation***

IBG, Inc. follows SFAS No. 123(R), "Share-Based Payment," to account for its stock-based compensation plans. SFAS No. 123(R) requires all share-based payments to employees to be recognized in the financial statements using a fair value-based method. As a result, IBG, Inc. expenses the fair value of stock granted to employees over the related vesting period.

***Cash and Cash Equivalents***

IBG, Inc. defines cash equivalents as short-term, highly liquid securities and cash deposits with original maturities of three months or less, other than those used for trading purposes.

***Cash and Securities — Segregated for Regulatory Purposes***

As a result of customer activities, certain Operating Companies are obligated by rules mandated by their primary regulators including the SEC and the Commodities Futures Trading Commission ("CFTC") in the United States, the Financial Services Authority in the United Kingdom and the Investment Dealers Association in Canada, to segregate or set aside cash or qualified securities to satisfy such regulations, which regulations have been promulgated to protect customer assets. In addition, substantially all of the Operating Companies are members of various clearing organizations at which cash or securities are deposited as required to conduct day-to-day clearance activities.

***Securities Borrowed and Securities Loaned***



## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

Securities borrowed and securities loaned are recorded at the amount of cash collateral advanced or received. Securities borrowed transactions require IBG, Inc. to provide counterparties with collateral, which may be in the form of cash, letters of credit, or other securities. With respect to securities loaned, IBG, Inc. receives collateral, which may be in the form of cash or other securities in an amount generally in excess of the fair value of the securities loaned.

IBG, Inc. monitors the market value of securities borrowed and loaned on a daily basis, with additional collateral obtained or refunded as permitted contractually. Receivables and payables with the same counterparty are not offset in the unaudited condensed consolidated statements of financial condition. For these transactions, the fees received or paid by IBG, Inc. are recorded as interest income or interest expense in the unaudited condensed consolidated statements of income.

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

***Securities Purchased Under Agreements to Resell and Securities Sold Under Agreements to Repurchase***

Securities purchased under agreements to resell and securities sold under agreements to repurchase are treated as collateralized financing transactions and are recorded at contract value, plus accrued interest, which approximates fair value. IBG, Inc.'s policy is to obtain possession of collateral with a fair value equal to or in excess of the principal amount loaned under resale agreements. To ensure that the fair value of the underlying collateral remains sufficient, this collateral is valued daily with additional collateral obtained or excess collateral returned, as permitted under contractual provisions.

***Financial Instruments Owned and Sold But Not Yet Purchased***

Stocks, government and corporate bonds, futures and options transactions are reported in the unaudited condensed consolidated financial statements on a trade date basis. All financial instruments owned and financial instruments sold but not yet purchased are recorded at fair value based upon quoted market prices. All firm-owned financial instruments pledged to counterparties where the counterparty has the right, by contract or custom, to sell or repledge the financial instruments are classified as financial instruments owned and pledged as collateral in the unaudited condensed consolidated statements of financial condition.

IBG, Inc. also enters into cross-currency swap transactions. These transactions, which are also reported on a trade date basis, are agreements to exchange a fixed amount of one currency for a specified amount of a second currency at the outset and at completion of the swap term. Unrealized mark-to-market gains and losses on cross-currency swap transactions are reported as components of financial instruments owned or financial instruments sold but not yet purchased in the unaudited condensed consolidated statements of financial condition. Net earnings or losses are reported as components of interest income in the unaudited condensed consolidated statements of income.

***Customer Receivables and Payables***

Customer securities transactions are recorded on a settlement date basis and customer commodities transactions are recorded on a trade date basis. Receivables from and payables to customers include amounts due on cash and margin transactions, including futures contracts transacted on behalf of customers. Securities owned by customers, including those that collateralize margin loans or other similar transactions, are not reported in the unaudited condensed consolidated statements of financial condition. Amounts receivable from customers that are determined by management to be uncollectible are written off to general and administrative expense.

***Receivables from and Payables to Brokers, Dealers and Clearing Organizations***

Receivables from brokers, dealers and clearing organizations include amounts receivable for securities not delivered by IBG, Inc. to the purchaser by the settlement date ("fails to deliver") and margin deposits. Payables to brokers, dealers and clearing organizations include amounts payable for securities not received by IBG, Inc. from a seller by the settlement date ("fails to receive"). Receivables and payables to brokers, dealers and clearing organizations also include amounts related to futures contracts executed on behalf of customers as well as net payables and receivables from unsettled trades.

***Investments***

IBG, Inc. makes certain strategic investments and accounts for these investments under the equity method of accounting. Investments are accounted for under the equity method of accounting when IBG, Inc. has significant influence over the investee as required under APB Opinion No. 18, "The Equity Method of Accounting for Investments in Common Stock." Investments accounted for under the equity method are recorded at the fair value amount of IBG, Inc.'s investment and adjusted each period for IBG, Inc.'s share of the investee's income or loss. IBG, Inc.'s share of the income or losses from equity investments is reported as a component of other income in the unaudited condensed consolidated statements of income and the recorded amounts of IBG, Inc.'s equity investments, which are included in other assets in the unaudited condensed consolidated statements of financial condition, increase or decrease accordingly. Distributions received from equity investees are recorded as reductions to the respective investment balance.

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

A judgmental aspect of accounting for investments is evaluating whether an other-than-temporary decline in the value of an investment has occurred. The evaluation of an other-than-temporary impairment is dependent on specific quantitative and qualitative factors and circumstances surrounding an investment, including recurring operating losses, credit defaults and subsequent rounds of financing. None of IBG, Inc.'s equity investments have readily determinable market

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

values. All equity investments are reviewed for changes in circumstances or occurrence of events that suggest IBG, Inc.'s investment may not be recoverable. If an unrealized loss on any investment is considered to be other-than-temporary, the loss is recognized in the period the determination is made. During the three month period ended September 30, 2008, an impairment charge of \$10.0 million was recorded on one of the Company's investments.

IBG, Inc. also holds exchange memberships and investments in equity securities of certain exchanges as required to qualify as a clearing member. Such investments are recorded at cost or, if an other-than-temporary impairment in value has occurred, at a value that reflects management's estimate of the impairment, and are included in other assets in the unaudited condensed consolidated statements of financial condition. Dividends are recognized as a component of other income as such dividends are received.

***Property and Equipment***

Property and equipment, which is a component of other assets, consist of purchased technology hardware and software, internally developed software, leasehold improvements and office furniture and equipment. Property and equipment are recorded at historical cost, less accumulated depreciation and amortization. Additions and improvements that extend the lives of assets are capitalized, while expenditures for repairs and maintenance are expensed as incurred. Depreciation and amortization are computed using the straight-line method. Equipment is depreciated over the estimated useful lives of the assets, while leasehold improvements are amortized over the lesser of the estimated economic useful life of the asset or the term of the lease. Computer equipment is depreciated over three to five years and office furniture and equipment are depreciated over five to seven years. Qualifying costs for internally developed software are capitalized and amortized over the expected useful life of the developed software, not to exceed three years.

***Comprehensive Income and Foreign Currency Translation***

Comprehensive income consists of two components: net income and other comprehensive income. Other comprehensive income refers to revenues, expenses, gains and losses that are included in stockholders' equity but are excluded from net income. IBG, Inc.'s other comprehensive income is comprised of foreign currency translation adjustments.

IBG, Inc.'s international Operating Companies have a functional currency (i.e., the currency in which activities are primarily conducted) that is other than the U.S. dollar. Such subsidiaries' assets and liabilities are translated into U.S. dollars at period-end exchange rates, and revenues and expenses are translated at average exchange rates prevailing during the period. Translation gains and losses from market making and electronic brokerage activities, respectively, are included in trading gains and in other income in the accompanying unaudited condensed consolidated statements of income. Adjustments that result from translating amounts from a subsidiary's functional currency are reported as a component of accumulated other comprehensive income.

***Revenue Recognition***

***— Trading Gains***

Trading gains and losses are recorded on trade date, and are reported on a net basis. Trading gains are comprised of changes in the fair value of trading assets and liabilities (i.e., unrealized gains and losses) and realized gains and losses. Dividends are integral to the valuation of stocks bought and sold and, accordingly, are reported on a net basis as a component of trading gains in the accompanying unaudited condensed consolidated statements of income.

***— Commissions and Execution Fees***

Commissions charged for executing and clearing customer transactions are accrued on a trade date basis and are reported as commissions and execution fees in the unaudited condensed consolidated statements of income, and the related expenses are reported as execution and clearing expenses, also on a trade date basis.

*Income Taxes*

IBG, Inc. accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes," which requires the recognition of tax benefits or expenses on the temporary differences between the financial reporting and tax bases of assets and liabilities, and FIN No. 48, "Accounting for Uncertainty in Income Taxes — an interpretation of FASB

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

Statement No. 109". FIN No. 48, which was adopted as of January 1, 2007, clarifies the accounting for uncertainty of income tax positions recognized in financial statements in accordance with SFAS No. 109. FIN No. 48 prescribes a "more likely than not" threshold and measurement attribute for recognition in the financial statements of an asset or liability resulting from a tax position taken or expected to be taken in an income tax return.

The Group historically operated in the United States as a limited liability company that was treated as a partnership for U.S. federal income tax purposes. Accordingly, the Group's income was not subject to U.S. federal income taxes. Taxes related to income earned by partnerships represent obligations of the individual partners. Income taxes shown in the Group's historical unaudited condensed consolidated statements of income have been primarily attributable to taxes incurred in non-U.S. entities. State and local income taxes reported in the unaudited condensed consolidated statements of income represent taxes assessed by jurisdictions that do not recognize the Group's limited liability company status. Outside the United States, the Group principally operates through subsidiary corporations and is subject to local income taxes. Foreign income taxes paid on dividends received are also reported as income taxes.

Subsequent to the IPO, income taxes have been provided for IBG, Inc.'s proportionate share of the Group's income that is subject to federal and state income taxes. IBG, Inc. recognizes interest related to income tax matters as interest income or expense and penalties related to income tax matters as income tax expense.

***Recently Issued Accounting Pronouncements***

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations." SFAS No. 141(R) replaces SFAS No. 141, mandating changes in the accounting for business combinations most notably that changes in purchase price allocations, if made, are required to be applied retrospectively, whereas under SFAS No. 141, such changes were applied prospectively. SFAS No. 141(R) is effective for an entity's fiscal year beginning after December 15, 2008, and early adoption is not permitted. The Company cannot anticipate whether adoption of SFAS No. 141(R) will have a material effect on its unaudited condensed consolidated financial statements as such effect would be solely dependent on whether the Company enters into business combinations after December 31, 2008 and the terms of such transactions.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51." SFAS No. 160 requires non-controlling ("minority") interests in a reporting entity to be reported as a component of the entity's stockholder's equity. SFAS No. 160 is effective for an entity's fiscal year beginning after December 15, 2008, and early adoption is not permitted. Management is assessing the potential impact on the Company's unaudited condensed consolidated financial statements of adopting SFAS No. 160.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133." SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities, and is effective for financial statements issued for fiscal years beginning after November 2008. Adoption of SFAS No. 161 is not expected to have a material effect on IBG, Inc.'s unaudited condensed consolidated statements of financial condition, income or cash flows.

On May 9, 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities in accordance with U.S. GAAP. This Statement will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." Adoption of SFAS No. 162 is not expected to have a material effect on IBG, Inc.'s unaudited condensed consolidated statements of financial condition, income or cash flows.

**3. Trading Activities and Related Risks**

IBG, Inc.'s trading activities include providing securities market making and brokerage services. Trading activities expose IBG, Inc. to market and credit risks. These risks are managed in accordance with established risk management policies and procedures. To accomplish this, management has established a risk management process that includes:

- a regular review of the risk management process by executive management as part of its oversight role;
- defined risk management policies and procedures supported by a rigorous analytic framework; and

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

- articulated risk tolerance levels as defined by executive management that are regularly reviewed to ensure that IBG, Inc.'s risk-taking is consistent with its business strategy, capital structure, and current and anticipated market conditions.

***Market Risk***

IBG, Inc. is exposed to various market risks. Exposures to market risks arise from equity price risk, foreign currency exchange rate fluctuations and changes in interest rates.

IBG, Inc. seeks to mitigate market risk associated with trading inventories by employing hedging strategies that correlate rate, price and spread movements of trading inventories and related financing and hedging activities. IBG, Inc. uses a combination of cash instruments and exchange traded derivatives to hedge its market exposures. The following discussion describes the types of market risk faced:

***Equity Price Risk***

Equity price risk arises from the possibility that equity security prices will fluctuate, affecting the value of equity securities and other instruments that derive their value from a particular stock, a defined basket of stocks, or a stock index. IBG, Inc. is subject to equity price risk primarily in securities owned and securities sold but not yet purchased. IBG, Inc. attempts to limit such risks by continuously reevaluating prices and by diversifying its portfolio across many different options, futures and underlying securities and avoiding concentrations of positions based on the same underlying security.

***Currency Risk***

Currency risk arises from the possibility that fluctuations in foreign exchange rates will impact the value of financial instruments. Exchange rate contracts may include cross-currency swaps and currency futures contracts. Currency swaps are agreements to exchange future payments in one currency for payments in another currency. These agreements are used to effectively convert assets or liabilities denominated in different currencies. Currency futures are contracts for delayed delivery of currency at a specified future date. IBG, Inc. uses currency swaps to manage the levels of its non-U.S. dollar currency balances and currency cash and futures to hedge its global exposure.

***Interest Rate Risk***

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments. IBG, Inc. is exposed to interest rate risk on cash and margin balances, positions carried in equity securities, options and futures and on its debt obligations. These risks are managed through investment policies and by entering into interest rate futures contracts.

***Credit Risk***

IBG, Inc. is exposed to risk of loss if an individual, counterparty or issuer fails to perform its obligations under contractual terms ("default risk"). Both cash instruments and derivatives expose IBG, Inc. to default risk. Credit risk is limited in that substantially all of the contracts entered into are settled directly at securities and commodities clearing houses and a small portion is settled through member firms and banks with substantial financial and operational resources. IBG, Inc. has established policies and procedures for mitigating credit risk on principal transactions, including reviewing and establishing limits for credit exposure, maintaining collateral, and continually assessing the creditworthiness of counterparties.

In the normal course of business, IBG, Inc. executes, settles and finances various customer securities transactions. Execution of these transactions includes the purchase and sale of securities by IBG, Inc. that exposes IBG, Inc. to default risk arising from the potential that customers or counterparties may fail to satisfy their obligations. In these situations, IBG, Inc. may be required to purchase or sell financial instruments at unfavorable market prices to satisfy obligations to customers or counterparties. IBG, Inc. seeks to control the risks associated with



## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

its customer margin activities by requiring customers to maintain collateral in compliance with regulatory and internal guidelines.

Liabilities to other brokers and dealers related to unsettled transactions (i.e., securities failed-to-receive) are recorded at the amount for which the securities were purchased, and are paid upon receipt of the securities from other brokers or dealers. In the case of aged securities failed-to-receive, IBG, Inc. may purchase the underlying security in the market and seek reimbursement for any losses from the counterparty.

## Interactive Brokers Group, Inc. and Subsidiaries

### Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

(dollars in thousands, except shares and per share amounts, unless otherwise noted)

For cash management purposes, IBG, Inc. enters into short-term securities purchased under agreements to resell and securities sold under agreements to repurchase transactions (“repos”) in addition to securities borrowing and lending arrangements, all of which may result in credit exposure in the event the counterparty to a transaction is unable to fulfill its contractual obligations. In accordance with industry practice, repos are collateralized by securities with a market value in excess of the obligation under the contract. Similarly, securities borrowed and loaned agreements are collateralized by deposits of cash or securities. IBG, Inc. attempts to minimize credit risk associated with these activities by monitoring collateral values on a daily basis and requiring additional collateral to be deposited with or returned to IBG, Inc. as permitted under contractual provisions.

#### *Concentrations of Credit Risk*

IBG, Inc.’s exposure to credit risk associated with its trading and other activities is measured on an individual counterparty basis, as well as by groups of counterparties that share similar attributes. Concentrations of credit risk can be affected by changes in political, industry, or economic factors. To reduce the potential for risk concentration, credit limits are established and exposure is monitored in light of changing counterparty and market conditions. As of September 30, 2008, the Company did not have any concentrations of credit risk.

#### *Off-Balance Sheet Risks*

IBG, Inc. may be exposed to a risk of loss not reflected in the unaudited condensed consolidated financial statements for futures products, which represent obligations of IBG, Inc. to settle at contracted prices, which may require repurchase or sale in the market at prevailing prices. Accordingly, these transactions result in off-balance sheet risk as IBG, Inc.’s cost to liquidate such futures contracts may exceed the amounts reported in IBG, Inc.’s unaudited condensed consolidated statements of financial condition.

#### **4. Initial Public Offering and Recapitalization**

On May 3, 2007, IBG, Inc. priced its initial public offering of shares of Common Stock. In connection with the IPO, IBG, Inc. purchased 10.0% of the membership interests in IBG LLC from IBG Holdings LLC, became the sole managing member of IBG LLC and began to consolidate IBG LLC’s financial results into its financial statements. Such transactions are collectively referred to herein as the “Recapitalization.” IBG Holdings LLC wholly owns all Class B common stock, which common stock has voting rights in proportion to its ownership interests in IBG LLC, approximately 89.6% as of September 30, 2008.

The unaudited condensed consolidated financial statements reflect the historical results of operations and financial position of IBG, Inc., including consolidation of its investment in IBG LLC from and after May 4, 2007. Prior to May 4, 2007, the unaudited condensed consolidated financial statements included herein represent the unaudited condensed consolidated financial statements of the Group. The historical unaudited condensed consolidated financial statements do not reflect what the financial position, results of operations or cash flows of IBG, Inc. or the Group would have been had these companies been stand-alone public companies for the periods presented. Specifically, the historical financial statements of the Group do not give effect to the following matters:

- the Recapitalization;
- U.S. corporate federal income taxes, since the Group operates in the U.S. as a limited liability company that is treated as a partnership for U.S. federal income tax purposes. Historically, the Group’s income was not subject to U.S. federal income taxes. Taxes related to income earned by partnerships represent obligations of the individual partners. Prior to May 4, 2007, income taxes reported on the unaudited condensed consolidated statements of income were primarily attributable to taxes incurred by non-U.S. entities. Outside the United States, the Group principally operates through subsidiary corporations and is subject to local income taxes. Foreign income taxes paid on dividends received are also reported as income taxes. Prior to May 4, 2007, state and local income taxes reported in the unaudited condensed consolidated statements of income represent taxes assessed by jurisdictions that do not recognize the Group’s limited liability company status. Subsequent to the IPO, the unaudited condensed consolidated financial statements of IBG, Inc. include U.S. federal and state income taxes on its allocable share of the taxable income of the Group, giving effect to the post-IPO

structure; and

- minority interest reflecting IBG Holdings LLC's ownership of IBG LLC membership interests.

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

***Initial Public Offering***

On May 9, 2007, IBG, Inc. issued, at \$30.01 per share, 40,000,000 shares (1,000,000,000 shares authorized) of its Common Stock in an initial public offering pursuant to the Registration Statement on Form S-1 (File No. 333-138955) (the "Registration Statement"). The aggregate gross proceeds from the IPO amounted to \$1,200.4 million. Net proceeds of \$1,177.9 million, after placement agency fees, were paid to IBG Holdings LLC in exchange for a 10.0% interest in IBG LLC.

***Recapitalization and Post-IPO Capital Structure***

Immediately prior to and immediately following the consummation of the IPO, IBG, Inc., IBG Holdings LLC, IBG LLC and the members of IBG LLC consummated a series of transactions collectively referred to herein as the "Recapitalization." In connection with the Recapitalization, IBG, Inc., IBG Holdings LLC and the historical members of IBG LLC entered into an exchange agreement, dated as of May 3, 2007 (the "Exchange Agreement"), pursuant to which the historical members of IBG LLC received membership interests in IBG Holdings LLC in exchange for their membership interests in IBG LLC. Additionally, IBG, Inc. became the sole managing member of IBG LLC.

In connection with the consummation of the IPO, IBG Holdings LLC used the net proceeds to redeem 10.0% of members' interests in IBG Holdings LLC in proportion to their interests. Immediately following the Recapitalization and IPO, IBG Holdings LLC owned approximately 90% of IBG LLC and 100% of IBG, Inc.'s Class B common stock, which has voting power in IBG, Inc. proportionate to the extent of IBG Holdings LLC's ownership of IBG LLC.

The Exchange Agreement also provides for future redemptions of member interests and for the purchase of member interests in IBG LLC by IBG, Inc. from IBG Holdings LLC, which is expected to result in IBG, Inc. acquiring the remaining member interests in IBG LLC that it does not own. On an annual basis, holders of IBG Holdings LLC member interests will be able to request redemption of such member interests over an eight (8) year period following the IPO; 12.5% annually for seven (7) years and 2.5% in the eighth year. The primary manner in which the redemption price is expected to be paid is from the proceeds from sales of additional shares of Common Stock. Three hundred sixty (360) million shares of authorized Common Stock were reserved for such future sales.

On April 24, 2008, IBG, Inc. filed with the Securities and Exchange Commission a Registration Statement on Form S-1 relating to the offering of 50 million shares of its Class A common stock. The net proceeds of the offering were intended to be used to purchase additional IBG LLC member interests from IBG Holdings LLC, pursuant to the terms and conditions of the Exchange Agreement. The offering was terminated without issuance of any shares. The shares offered in the offering were deregistered and IBG, Inc. has agreed not to register another public offering of its shares of Class A common stock until at least April 15, 2009.

In lieu of the above-referenced offering, the Exchange Agreement provides that IBG LLC, using its available liquidity, may facilitate the redemption by IBG Holdings LLC of interests held by its members. In May 2008, with the consent of IBG Holdings LLC and IBG, Inc. (on its own behalf and acting as the sole managing member of IBG LLC), IBG LLC agreed to redeem membership interests from IBG Holdings LLC at their fair value of \$72,015, equivalent to \$29.99 per share of Class A common stock. As a consequence of this transaction, IBG, Inc.'s interest in IBG LLC increased to approximately 10.4%, with IBG Holdings LLC owning the remaining 89.6%. The redemptions also resulted in an increase in the IBG Holdings LLC interest held by Thomas Peterffy and his affiliates from approximately 84.6% to approximately 85.2%.

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

As a result of a federal income tax election made by IBG LLC applicable to the acquisition of IBG LLC member interests by IBG, Inc. the income tax basis of the assets of IBG LLC acquired by IBG, Inc. have been adjusted based on the amount paid for such interests. A deferred tax asset of \$380,785 was recorded as of the IPO date, which deferred tax asset is being amortized as additional deferred income tax expense over 15 years, as allowable under current tax law. As of September 30, 2008 and December 31, 2007, the unamortized balance of the deferred tax asset was \$356,058 and \$369,748, respectively. IBG, Inc. also entered into an agreement (the "Tax Receivable Agreement") with IBG Holdings LLC to pay IBG Holdings LLC (for the benefit of the former members of IBG LLC) 85% of the tax savings that IBG, Inc. actually realizes as the result of the tax basis increase. As of the IPO date, a payable to IBG Holdings LLC of \$323,668 was recorded by IBG, Inc. Amounts payable under the Tax Receivable Agreement are subject to repayment to IBG Holdings LLC annually upon the filing of IBG, Inc.'s federal income tax return. Through November 10, 2008 no payments have been made to IBG Holdings LLC for 2007 pursuant to the terms of the Tax Receivable Agreement. The remaining 15%, \$57,117, has been accounted for as a permanent increase to additional paid-in capital in the unaudited condensed consolidated statement of financial condition.

**Interactive Brokers Group, Inc. and Subsidiaries****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)****(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

Since consummation of the IPO and Recapitalization, IBG, Inc.'s equity capital structure has been comprised of Class A and Class B common stock. All shares of common stock have a par value of \$0.01 per share and have identical rights to earnings and dividends and in liquidation. As described previously in Note 2 and in this Note 4, Class B common stock has voting power in IBG, Inc. proportionate to the extent of IBG Holdings LLC's ownership of IBG LLC. At September 30, 2008, 1,000,000,000 shares of Class A common stock are authorized, of which 43,270,823 shares have been issued and 40,602,415 and 40,143,760 shares were outstanding as of September 30, 2008 and December 31, 2007, respectively. Class B common stock is comprised of 100 authorized shares, of which 100 shares were issued and outstanding as of September 30, 2008 and December 31, 2007. In addition, 10,000 shares of preferred stock have been authorized, of which no shares are issued or outstanding as of September 30, 2008 and December 31, 2007.

***Stock Repurchase Program***

On September 26, 2008, the Company announced that the Board of Directors had approved the repurchase by IBG LLC of up to eight (8) million shares of its Class A common stock. Shares may be purchased from time to time in the open market and in private transactions if the company deems the price appropriate. Through November 10, 2008, no shares have been repurchased.

***Earnings per Share***

Historical earnings per share information is not applicable for reporting periods prior to the consummation of the IPO. The calculation of basic and diluted earnings per share is described below:

Basic earnings per share are calculated utilizing net income available for common stockholders divided by the weighted average number of shares of Class A and Class B common stock outstanding for that period:

	<b>Three month period ended September 30, 2008</b>	<b>Three month period ended September 30, 2007</b>	<b>Nine month period ended September 30, 2008</b>	<b>Period from May 4, 2007 through September 30, 2007</b>
<b>Basic earnings per share:</b>				
Net income available for common stockholders	\$ 27,147	\$ 22,243	\$ 72,686	\$ 29,249
<b>Weighted average shares of common stock outstanding:</b>				
Class A	40,602,415	40,142,096	40,386,479	40,159,827
Class B	100	100	100	100
	40,602,515	40,142,196	40,386,579	40,159,927
Basic earnings per share	\$ 0.67	\$ 0.55	\$ 1.80	\$ 0.73

Diluted earnings per share are calculated utilizing net income available for common stockholders divided by the weighted average percentage of IBG LLC interests owned by IBG, Inc. to arrive at an amount of net income that would be available for common stockholders on a fully-diluted basis if all member interests in IBG LLC currently held by IBG Holdings LLC had been sold to IBG, Inc. and an equivalent number of shares of

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

Common Stock had been issued by IBG, Inc. This resulting net income is divided by the weighted average total number of shares of Class A and Class B common stock for the periods presented that would be outstanding if such a transaction had occurred, and includes shares of Common Stock issued and issuable pursuant to the 2007 ROI Unit Stock Plan and shares of Common Stock issued under the 2007 Stock Incentive Plan (Note 5).

## Interactive Brokers Group, Inc. and Subsidiaries

## Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

(dollars in thousands, except shares and per share amounts, unless otherwise noted)

	Three month period ended September 30, 2008	Three month period ended September 30, 2007	Nine month period ended September 30, 2008	Period from May 4, 2007 through September 30, 2007
<b>Diluted earnings per share:</b>				
Net income available for common stockholders	\$ 260,751	\$ 211,948	\$ 702,686	\$ 278,732
Weighted average shares of common stock outstanding:				
Class A:				
Issued and outstanding	40,602,415	40,142,096	40,386,479	40,159,827
Assumed issuance in exchange for remaining interests in IBG LLC	357,561,194	360,000,000	358,740,610	360,000,000
Issuable pursuant to 2007 ROI Unit Stock Plan	948,376	1,173,285	1,053,250	1,174,201
Class B	100	100	100	100
	399,112,085	401,315,481	400,180,439	401,334,128
Diluted earnings per share	\$ 0.65	\$ 0.53	\$ 1.76	\$ 0.69

**5. Employee Incentive Plans*****Return on Investment Dollar Units ("ROI Dollar Units")***

From 1998 through January 1, 2006, IBG LLC granted all non-member employees ROI Dollar Units, which are redeemable under the amended provisions of the plan, and in accordance with regulations issued by the Internal Revenue Service (Section 409A of the Internal Revenue Code). Upon redemption, the grantee is entitled to accumulated earnings on the face value of the certificate, but not the actual face value. For grants made in 1998 and 1999, grantees may redeem the ROI Dollar Units after vesting on the fifth anniversary of the date of their grant and prior to the tenth anniversary of the date of their grant. For grants made between January 1, 2000 and January 1, 2005, grantees must elect to redeem the ROI Dollar Units upon the fifth, seventh or tenth anniversary date. These ROI Dollar Units will vest upon the fifth anniversary of the date of their grant and will continue to accumulate earnings until the elected redemption date. For grants made on or after January 1, 2006, all ROI Dollar Units shall vest on the fifth anniversary date of their grant and will be automatically redeemed. Subsequent to the IPO, no additional ROI Dollar Units have been or will be granted, and non-cash compensation to employees will consist primarily of grants of shares of Common Stock as described below under "2007 Stock Incentive Plan."

As of September 30, 2008 and December 31, 2007, payables to employees for ROI Dollar Units were \$22,173 and \$21,710, respectively. Of these payable amounts, \$3,755 and \$7,019 were vested as of September 30, 2008 and December 31, 2007, respectively. These amounts are included in accounts payable, accrued expenses and other liabilities in the unaudited condensed consolidated statements of financial condition. Compensation expense for the ROI Dollar Unit plan, included in the unaudited condensed consolidated statement of income for the nine month period ended September 30, 2008 was \$5,713.

***2007 ROI Unit Stock Plan***

In connection with the IPO, IBG, Inc. adopted the Interactive Brokers Group, Inc. 2007 ROI Unit Stock Plan (the "ROI Unit Stock Plan"). Under this plan, certain employees of the Group who held ROI Dollar Units, at the employee's option, elected to invest their ROI Dollar Unit accumulated earnings as of December 31, 2006 in shares of Common Stock. An aggregate of 1,271,009 shares of Common Stock (consisting of 1,250,000 shares issued under the ROI Unit Stock Plan and 21,009 shares under the 2007 Stock Incentive Plan, as described below), with a fair value at the date of grant of \$38,143, were issued to IBG LLC, to be held as Treasury stock, and were distributed or are distributable to employees in accordance with the following schedule, subject to the conditions below:



Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

- 10% on the date of the IPO (or on the first anniversary of the IPO, in the case of U.S. ROI Unit holders who made the above-referenced elections after December 31, 2006); and

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

- an additional 15% on each of the first six anniversaries of the date of the IPO (or on each of the next six anniversaries of the date of the IPO, in the case of U.S. ROI Unit holders who made the above-referenced elections after December 31, 2006), assuming continued employment with IBG, Inc. and compliance with other applicable covenants.

Of the fair value at the date of grant, \$17,806 represented the accumulated ROI Dollar Unit value elected to be invested by employees in Common Stock and such amount was accrued for as of December 31, 2006. The remainder will be ratably accrued as compensation expense by the Group from the date of the IPO over the requisite service period represented by the aforementioned distribution schedule. Compensation expense for the 2007 ROI Unit Stock Plan and related grants under the 2007 Stock Incentive Plan, net of the effect of forfeitures, included in the unaudited condensed consolidated statement of income for the nine month period ended September 30, 2008 was \$3,737.

***2007 Stock Incentive Plan***

Under the Interactive Brokers Group, Inc. 2007 Stock Incentive Plan (the "Stock Incentive Plan"), up to 9.2 million shares of Common Stock may be granted and issued to directors, officers, employees, contractors and consultants of IBG, Inc. and its subsidiaries. The purpose of the Stock Incentive Plan is to promote IBG, Inc.'s long-term financial success by attracting, retaining and rewarding eligible participants.

The Stock Incentive Plan is administered by the Compensation Committee of IBG, Inc.'s Board of Directors. The Compensation Committee has discretionary authority to determine which employees are eligible to participate in the Stock Incentive Plan. The Compensation Committee establishes the terms and conditions of the awards under the Stock Incentive Plan, including the number of awards offered to each employee and all other terms and conditions applicable to such awards in individual grant agreements. Awards are expected to be made primarily through grants of Common Stock. The Stock Incentive Plan will provide that awards will be subject to issuance over time and may be forfeited upon an employee's termination of employment or violation of certain applicable covenants prior to issuance, unless determined otherwise by the Compensation Committee.

The Stock Incentive Plan provides that, upon a change in control, the Compensation Committee may, at its discretion, fully vest any granted but unissued shares of Common Stock awarded under the Stock Incentive Plan, or provide that any such granted but unissued shares of Common Stock will be honored or assumed, or new rights substituted therefore by the new employer on a substantially similar basis and on terms and conditions substantially comparable to those of the Stock Incentive Plan.

IBG, Inc. granted awards of 927,943 shares of Common Stock, with a fair value at the date of grant of \$27,847, in connection with the IPO and is expected to continue to grant awards on or about January 1 of each year following the IPO, to eligible employees as part of an overall plan of equity compensation. The shares of Common Stock granted at the time of the IPO were issued to IBG LLC, to be held as Treasury Stock, and were distributed or will be distributable to employees in accordance with the following schedule:

- 10% on the date of the IPO; and
- an additional 15% on each of the first six anniversaries of the date of the IPO, assuming continued employment with IBG, Inc. and compliance with non-competition and other applicable covenants.

Of the fair value at the date of grant, \$14,674 represented compensation accrued as of December 31, 2006 to former members of IBG LLC, with the remainder to be ratably accrued as compensation expense by the Group from the date of the IPO over the requisite service period represented by the aforementioned distribution schedule.

On July 31, 2007 the Company granted an additional 16,665 shares of Common Stock to certain employees, with a fair value at the date of grant of \$404. 10% of these shares were distributed to the employees during the 4<sup>th</sup> quarter of 2007 with the remaining shares, also held as Treasury Stock, to be distributed on the following six anniversaries of the IPO with other Stock Incentive Plan grants made during 2007 under the aforementioned distribution schedule.

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

For the year ended December 31, 2007, the Company granted awards with a fair value at the date of grant of \$32,876. 1,055,206 shares of Common Stock were issued to IBG LLC as of December 31, 2007. These shares of Common Stock are being held as Treasury Stock, and will be distributed to employees in accordance with the following schedule:

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

- 10% on the anniversary of the IPO; and
- an additional 15% on each of the next six anniversaries of the date of the IPO, assuming continued employment with IBG, Inc. and compliance with non-competition and other applicable covenants.

Estimated future grants under the Stock Incentive Plan will be accrued for ratably during each year under the SFAS No. 123(R) "Graded Vesting" method. Compensation expense recognized in the unaudited condensed consolidated statement of income for the nine month period ended September 30, 2008 was \$16,918.

On the date of the IPO, 187,953 shares, valued at \$5,640, were distributed to employees. During the third quarter of 2007, 45,857 shares valued at \$1,376 were purchased by IBG, Inc. from employees in connection with those employees' elections to sell a portion of their shares in order to meet their personal income tax obligations incurred as a result of share distributions. Shares purchased have been recorded as Treasury Stock.

On May 9, 2008, 458,655 shares of Class A common stock, with a total grant date fair value of \$13.9 million were distributed to employees pursuant to the 2007 ROI Unit Stock Plan and the Stock Incentive Plan. As provided for under the terms of the plans, certain employees elected to sell, and the Company facilitated the sale of, 121,852 of the distributed shares to meet the employees' personal income tax withholding obligations arising from this share distribution.

Shares granted under the 2007 ROI Unit Stock Plan and the Stock Incentive Plan are subject to forfeiture in the event an employee ceases employment with the Company. The plans provide that employees who discontinue employment with the Company without cause and continue to meet the terms of the plans' post-employment provisions will forfeit 50% of unvested previously granted shares unless the employee is over the age of 59, in which case the employee would be eligible to receive 100% of unvested shares previously granted. Distributions of remaining shares to former employees will occur annually following the discontinuation of employment over a five (5) year vesting schedule, 12.5% in each of the first four years and 50% in the fifth year. As of September 30, 2008, no shares have been distributed under these post-employment provisions.

The following is a summary of Stock Plan activity for the nine month period ended September 30, 2008:

	<b>2007 Stock Incentive Plan Shares</b>	<b>2007 ROI Unit Stock Plan Shares</b>
Balance, December 31, 2007	1,916,744	1,151,932
Granted	-	-
Forfeited by employees	(27,971)	(4,132)
Distributed to employees	(239,141)	(219,514)
Balance, September 30, 2008	1,649,632	928,286

**6. Financial Instruments Owned and Sold, But Not Yet Purchased, at Fair Value**

Financial instruments owned, including those pledged as collateral, and financial instruments sold, but not yet purchased consisted of securities, at fair value, as follows at September 30, 2008 and December 31, 2007:

	September 30, 2008		December 31, 2007	
	Owned	Sold, But Not Yet Purchased	Owned	Sold, But Not Yet Purchased
Stocks	\$ 4,982,400	\$ 3,106,533	\$ 8,594,567	\$ 6,247,069
Options	8,173,761	8,293,522	7,354,818	8,068,721
U.S. and foreign government obligations	367,612	-	727,453	-
Warrants	179,997	26	98,357	-
Corporate bonds	6,553	52	6,521	63
Discount certificates	20,827	-	75,797	-
Currency forward contracts	4,214	-	-	-
	\$13,735,364	\$11,400,133	\$16,857,513	\$14,315,853

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

**(dollars in thousands, except shares and per share amounts, unless otherwise noted)**

**7. Commitments, Contingencies and Guarantees**

***Litigation***

IBG, Inc. is subject to certain pending and threatened legal actions which arise out of the normal course of business. Litigation is inherently unpredictable, particularly in proceedings where claimants seek substantial or indeterminate damages, or which are in their early stages. IBG, Inc. cannot predict with certainty the actual loss or range of loss related to such legal proceedings, the manner in which they will be resolved, the timing of final resolution or the ultimate settlement. Consequently, IBG, Inc. cannot estimate losses or ranges of losses related to such legal matters, even in instances where it is reasonably possible that a future loss will be incurred.

On January 14, 2008, the Company was named as a defendant in a purported shareholder class action lawsuit alleging that the Company violated Sections 11 and 12(a)(2) of the Securities Act by issuing a Registration Statement and Prospectus in connection with its initial public offering that contained false and misleading statements or omitted material facts concerning losses suffered by the Company in connection with trading in options of Altana AG on the German stock market. A lead plaintiff was appointed on March 14, 2008, and an amended complaint was served on or about March 24, 2008. The amended complaint adds the Company's founder and chief executive officer, Thomas Peterffy, as a defendant. The amended complaint asserts claims against the Company under Sections 11 and 12(a)(2) of the Securities Act, and against Mr. Peterffy under Sections 11 and 15 of the Securities Act, based on the allegations that the Registration Statement failed to disclose \$25 million in trading losses in the first quarter of 2007 that resulted from unusually high volume in advance of certain corporate announcements as well as the alleged failure to disclose the losses in trading options of Altana AG. Defendants believe the action is without merit and intend to defend themselves vigorously. In the opinion of management, after consultation with counsel, the resolution of this matter and all other ongoing legal proceedings will not have a material adverse effect on the consolidated financial condition, results of operations or cash flows of IBG, Inc. IBG, Inc. accounts for potential losses related to litigation in accordance with SFAS No. 5 "Accounting for Contingencies." As of September 30, 2008 and December 31, 2007, reserves provided for potential losses related to litigation matters were not material.

***Guarantees***

Certain of the Operating Companies provide guarantees to securities clearing houses and exchanges which meet the accounting definition of a guarantee under FIN No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others." Under the standard membership agreement, members are required to guarantee collectively the performance of other members. Under the agreements, if another member becomes unable to satisfy its obligations to the clearinghouse, other members would be required to meet shortfalls. In the opinion of management, the Operating Companies' liability under these arrangements is not quantifiable and could exceed the cash and securities they have posted as collateral. However, the potential for these Operating Companies to be required to make payments under these arrangements is remote. Accordingly, no contingent liability is carried on the unaudited condensed consolidated statements of financial condition for these arrangements.

In connection with its retail brokerage business, IB LLC performs securities and commodities execution, clearance and settlement on behalf of its customers for whom it commits to settle trades submitted by such customers with the respective clearing houses. If a customer fails to fulfill

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

its obligation, IB LLC must fulfill the customer's obligation with the trade counterparty. No contingent liability is carried on the unaudited condensed consolidated statements of financial condition for such customer obligations.

IB LLC is fully secured by assets in customers' accounts and any proceeds received from securities and commodities transactions entered into by IB LLC on behalf of customers. No contingent liability is carried on the unaudited condensed consolidated statements of financial condition for these fully collateralized transactions.

### *Other Commitments*

Certain clearing houses and clearing banks and firms used by certain Operating Companies are given a security interest in certain assets of those Operating Companies held by those clearing organizations. These assets may be applied to satisfy the obligations of those Operating Companies to the respective clearing organizations.

### **8. Segment and Geographic Information**

IBG, Inc. operates in two business segments, market making and electronic brokerage. IBG, Inc. conducts its market making business through its Timber Hill subsidiaries on the world's leading exchanges and market centers, primarily in exchange-traded equities, equity options and equity-index options and futures. IBG, Inc. conducts its electronic brokerage business through its Interactive Brokers subsidiaries, which provide electronic execution and clearing services to customers worldwide.

**Interactive Brokers Group, Inc. and Subsidiaries****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

(dollars in thousands, except shares and per share amounts, unless otherwise noted)

There are significant transactions and balances between the Operating Companies, primarily as a result of certain Operating Companies holding exchange or clearing organization memberships, which are utilized to provide execution and clearing services to affiliates. Intra-segment and intra-region income and expenses and related balances have been eliminated in this segment and geographic information in order to accurately reflect the external business conducted in each segment or geographical region. Rates on transactions between segments are designed to approximate full costs. Corporate items include non-allocated corporate income and expenses that are not attributed to segments for performance measurement, corporate assets and eliminations.

Management believes that the following information by business segment provides a reasonable representation of each segment's contribution to total net revenues, income before income taxes and minority interest for the three and nine month periods ended September 30, 2008 and 2007 and to total assets as of September 30, 2008 and December 31, 2007:

	Three month period ended September 30,		Nine month period ended September 30,	
	2008	2007	2008	2007
<b>Net revenues:</b>				
Market making	\$ 359,572	\$ 329,523	\$ 1,034,646	\$ 752,259
Electronic brokerage	134,479	111,575	386,997	306,862
Corporate and eliminations	2,944	4,055	(824)	11,573
Total net revenues	\$ 496,995	\$ 445,153	\$ 1,420,819	\$ 1,070,694
<b>Income before income taxes:</b>				
Market making	\$ 283,003	\$ 245,136	\$ 805,979	\$ 515,626
Electronic brokerage	63,787	56,333	180,906	135,785
Corporate and eliminations	600	6,396	(6,181)	11,445
Total income before income taxes and minority interest	\$ 347,390	\$ 307,865	\$ 980,704	\$ 662,856

	September 30, 2008	December 31, 2007
<b>Segment assets:</b>		
Market making	\$ 21,693,847	\$ 26,914,815
Electronic brokerage	8,518,551	8,935,387
Corporate and eliminations	(860,721)	(1,308,116)
Total assets	\$ 29,351,677	\$ 34,542,086



**Interactive Brokers Group, Inc. and Subsidiaries****Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

(dollars in thousands, except shares and per share amounts, unless otherwise noted)

IBG, Inc. operates its automated global business in U.S. and international markets on more than 70 exchanges and market centers. A significant portion of IBG, Inc.'s net revenues are generated by consolidated subsidiaries operating outside the United States. International operations are comprised of market making and electronic brokerage activities in 27 countries in Europe, Asia and North America (outside the United States). The following table presents total net revenues and income before income taxes and minority interest by geographic area for the three and nine month periods ended September 30, 2008 and 2007:

	Three month period ended September 30,		Nine month period ended September 30,	
	2008	2007	2008	2007
<b>Net revenues:</b>				
United States	\$ 244,157	\$ 292,186	\$ 820,646	\$ 755,571
International	255,943	148,461	606,982	305,434
Corporate and eliminations	(3,105)	4,506	(6,809)	9,689
<b>Total net revenues</b>	<b>\$ 496,995</b>	<b>\$ 445,153</b>	<b>\$ 1,420,819</b>	<b>\$ 1,070,694</b>
<b>Income before income taxes:</b>				
United States	\$ 150,719	\$ 201,235	\$ 537,119	\$ 484,692
International	202,047	99,551	455,684	168,331
Corporate and eliminations	(5,376)	7,079	(12,099)	9,833
<b>Total income before income taxes and minority interest</b>	<b>\$ 347,390</b>	<b>\$ 307,865</b>	<b>\$ 980,704</b>	<b>\$ 662,856</b>

**9. Regulatory Requirements**

At September 30, 2008, aggregate excess regulatory capital for all of the Operating Companies was \$2,287,205.

TH LLC and IB LLC are subject to the Uniform Net Capital Rule (Rule 15c3-1) under the Exchange Act and the CFTC's minimum financial requirements (Regulation 1.17). At September 30, 2008, TH LLC had net capital of \$1,035,962, which was \$1,025,635 in excess of required net capital of \$10,327, and IB LLC had net capital of \$551,525, which was \$503,922 in excess of required net capital of \$47,603.

THE is subject to the Swiss National Bank eligible equity requirement. At September 30, 2008, THE had eligible equity of \$937,244, which was \$600,658 in excess of the minimum requirement of \$336,586.

THSHK is subject to the Hong Kong Securities Futures Commission liquid capital requirement, THA is subject to the Australian Stock Exchange liquid capital requirement, THC and IBC are subject to the Investment Dealers Association of Canada risk-adjusted capital requirement and IBUK is subject to the U.K. Financial Services Authority financial resources requirement.

At September 30, 2008, all of the Operating Companies were in compliance with their respective regulatory capital requirements.

Regulatory capital requirements could restrict the Operating Companies from expanding their business and declaring dividends if their net capital does not meet regulatory requirements. Also, certain entities within IBG, Inc. are subject to other regulatory restrictions and requirements.

**10. Related Party Transactions**

Receivable from affiliate represents amounts advanced to IBG Holdings LLC. Included in receivable from and payable to customers in the accompanying unaudited condensed consolidated statement of financial condition as of September 30, 2008 are director and officer account balances of \$66,465 and \$129,798, respectively. Included in senior notes payable at September 30, 2008 are senior notes purchased by directors and their affiliates of \$12,979.

**Interactive Brokers Group, Inc. and Subsidiaries**

**Notes to Unaudited Condensed Consolidated Financial Statements (Continued)**

(dollars in thousands, except shares and per share amounts, unless otherwise noted)

**11. Restatement**

In connection with the preparation of the Company's annual report on Form 10-K for the year ended December 31, 2007, management identified the following errors in the Company's previously issued condensed consolidated statement of cash flows for the nine months ended September 30, 2007.

1. Cash capital contribution of \$33,118 received by a 10% owned consolidated subsidiary from an unconsolidated affiliate was erroneously reported net of minority interest liability instead of gross in cash flows from financing activities.
2. Dividends paid to an unconsolidated affiliate, IBG Holdings LLC, by IBG LLC, an operating subsidiary of IBG, Inc., after its May 4, 2007 IPO of \$102,431 were erroneously classified as cash flows from operating activities instead of cash flows from financing activities.
3. Dividends received by IBG, Inc. from IBG LLC of \$11,982 were erroneously included in cash flows from investing activities.
4. Within cash flows from operating activities:
  - Net income available for common stockholders of \$29,249 was reported instead of net income of \$281,581, and pre-IPO IBG LLC net income of \$252,332 was included in the minority interest adjustment to reconcile net income to net cash provided by operating activities. This error had no effect on IBG, Inc.'s results of operations in its unaudited condensed consolidated statement of income.
  - Shares distributed to employees during the nine months ended September 30, 2007, which were expensed in previous periods of \$5,640 and (gains)/losses on non-trading investments of \$3,391 were included in adjustments to reconcile net income to net cash provided by operating activities instead of as changes in operating assets and liabilities.
  - Increase in deferred tax assets and related payable to affiliate of \$248,347 and \$211,095, respectively, which are non-cash activities, were included as changes in operating assets and liabilities.

The Company also identified an error related to the calculation of deferred taxes associated with its IPO that resulted in understatements of deferred tax assets, amounts payable to IBG Holdings LLC and additional paid in capital as of September 30, 2007 in the respective amounts of \$132,438, \$112,573 and \$19,865. The condensed consolidated statement of cash flows for the nine months ended September 30, 2007 was corrected accordingly for the above errors. These corrections had no effect on IBG, Inc.'s results of operations or on total net change in cash for the period.



## Interactive Brokers Group, Inc. and Subsidiaries

## Notes to Unaudited Condensed Consolidated Financial Statements (Continued)

(dollars in thousands, except shares and per share amounts, unless otherwise noted)

The line items impacted by the restatement of the unaudited condensed consolidated statement of cash flows for the nine months ended September 30, 2007 are as follows:

	Nine months ended September 30,		
	As Previously Reported	Adjustment	As Restated
<b>Cash flows from operating activities:</b>			
Net Income	\$ 29,249	\$ 252,332	\$ 281,581
Minority Interest	594,732	(252,332)	342,400
Employee stock plan compensation	16,627	(5,640)	10,987
(Gains) losses on non-trading investments, net	(4,557)	3,391	(1,166)
Changes in operating assets and liabilities:			
Other assets	(248,306)	\$ 241,964	(6,342)
Other payables	703,645	(158,420)	545,225
Other net cash flows from operating activities	(967,157)	--	(967,157)
<b>Total cash flows from operating activities</b>	<b>124,233</b>	<b>81,295</b>	<b>205,528</b>
<b>Cash flows from investing activities:</b>			
Dividends received from IBG LLC	11,982	(11,982)	-
Other net cash flows from investing activities	(1,200,590)	-	(1,200,590)
<b>Total cash flows from investing activities</b>	<b>(1,188,608)</b>	<b>(11,982)</b>	<b>(1,200,590)</b>
<b>Cash flows from financing activities:</b>			
Dividends paid to IBG Holdings LLC after May 3, 2007	-	(102,431)	(102,431)
Cash capital contribution to THE	3,882	33,118	37,000
Other net cash flows from financing activities	863,421	-	863,421
<b>Total cash flows from financing activities:</b>	<b>867,303</b>	<b>(69,313)</b>	<b>797,990</b>
<b>Effect of exchange rate changes on cash and cash equivalents</b>	<b>28,611</b>	<b>-</b>	<b>28,611</b>
<b>Net change in cash and cash equivalents</b>	<b>(\$ 168,461)</b>	<b>\$ 0</b>	<b>(\$ 168,461)</b>
<b>Supplemental disclosures of cash flow information:</b>			
IPO related transactions:			
Deferred tax asset arising from IPO	\$ -	\$ 380,785	\$ 380,785
Payable to affiliate	-	323,668	323,668
Net tax benefit retained, recorded as additional paid in capital	\$ -	\$ 57,117	\$ 57,117

\*\*\*\*\*



## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS

### OF OPERATIONS

The following discussion should be read in conjunction with the unaudited condensed consolidated financial statements and the related notes in Item 1, included elsewhere in this report. This discussion includes the effects of the restatement reported in Item 1 of this Quarterly Report on Form 10-Q, which restatement affects the discussion of Cash Flows on page 43.

In addition to historical information, the following discussion also contains forward-looking statements that include risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under the heading "Risk Factors" in our Annual Report on Form 10-K filed with the SEC on March 27, 2008 and elsewhere in this report.

#### Introduction

IBG, Inc. is a holding company whose primary assets are our ownership of approximately 10.4% of the membership interests of the Group.

We are an automated global electronic market maker and broker specializing in routing orders and executing and processing trades in securities, futures and foreign exchange instruments on more than 70 electronic exchanges and trading venues around the world. Since our inception in 1977, we have focused on developing proprietary software to automate broker-dealer functions. The advent of electronic exchanges in the last 18 years has provided us with the opportunity to integrate our software with an increasing number of exchanges and trading venues into one automatically functioning, computerized platform that requires minimal human intervention.

The Company reports its results in two business segments, market making and electronic brokerage. These segments are analyzed separately as we derive our revenues from these two principal business activities as well as allocate resources and assess performance.

- *Market Making.* We conduct our market making business through our Timber Hill subsidiaries. As one of the largest market makers on many of the world's leading exchanges, we provide liquidity by offering competitively tight bid/offer spreads over a broad base of approximately 532,000 tradable, exchange-listed products. As principal, we commit our own capital and derive revenues or incur losses from the difference between the price paid when securities are bought and the price received when those securities are sold. Because we provide continuous bid and offer quotations and we are continuously both buying and selling quoted securities, we may have either a long or a short position in a particular product at a given point in time. Our entire portfolio is evaluated each second and continuously rebalanced throughout the trading day, thus minimizing the risk of our portfolio at all times. This real-time rebalancing of our portfolio, together with our real-time proprietary risk management system, enables us to curtail risk and to be profitable in both up-market and down-market scenarios.
- *Electronic Brokerage.* We conduct our electronic brokerage business through our Interactive Brokers subsidiaries. As an electronic broker, we execute, clear and settle trades globally for both institutional and individual customers. Capitalizing on the technology originally developed for our market making business, IB's systems provide our customers with the capability to monitor multiple markets around the world simultaneously and to execute trades electronically in these markets at a low cost, in multiple products and currencies from a single trading account. We offer our customers access to all classes of tradable, exchange-listed products, including stocks, bonds, options, futures, forex and mutual funds, traded on more than 70 exchanges and market centers and in 17 countries around the world seamlessly.

When we use the terms "we," "us," and "our," we mean IBG LLC and its subsidiaries for periods prior to the IPO, and IBG, Inc. and its subsidiaries (including IBG LLC) for periods from and after the IPO. On May 3, 2007, IBG, Inc. priced its initial public offering of shares of Common Stock. In connection with the IPO, IBG, Inc. purchased 10.0% of the membership interests in IBG LLC, became the sole managing member of IBG LLC and began to consolidate IBG LLC's financial results into its financial statements. Historical results of operations are reported as a limited liability company until the IPO and do not include, franchise tax, minority interest, and federal income taxes. Such items are included in subsequent periods. Therefore the historical results for periods prior to the IPO and subsequent thereto are not comparable. This MD&A includes certain pro forma financial data to present our results of operations on a more comparable basis. See "Results of Operations" below for additional information regarding pro forma financial data.

## Executive Overview

**Third quarter results:** Diluted earnings per share were \$0.65 for the three months ended September 30, 2008, 23% higher than the same period last year. The calculation of diluted earnings per share is detailed in Note 4, "Initial Public Offering and Recapitalization," to the unaudited condensed consolidated financial statements, Part 1, Item 1 of this Quarterly Report on Form 10-Q. IBG, Inc.'s diluted earnings per share were \$0.53 for the three months ended September 30, 2007.

Our income before income taxes and minority interest increased 52%, to \$1,249 million, during the past 12 months versus the prior 12 month period.

**Consolidated:** For the three months ended September 30, 2008, our net revenues were \$497.0 million and income before income taxes and minority interest was \$347.4 million, compared to net revenues of \$445.1 million and income before income taxes and minority interest of \$307.9 million for the same period in 2007. Trading gains were 25% higher in the third quarter of 2008 compared to the same period last year and commissions and execution fees were up by 41% for the same time period. Our pre-tax margin, for the three months ended September 30, 2008, was 70%, compared to 69% for the same period in 2007.

**Market Making:** During the three months ended September 30, 2008, income before income taxes in our market making segment increased 16%, compared with the three months ended September 30, 2007, and 40% sequentially. The year over year increase is consistent with the continued growth of our global market making business. The substantial sequential increase from the second quarter was due to an exceptional market environment with high volumes and volatility, which allowed us to leverage our automated trading and real-time risk management system and reflected positively in our results. Pre-tax margin was 79% for the quarter ended September 30, 2008, highlighting leverage from automation.

Market making options and futures contract volumes increased 10% and 47%, respectively, for the three months ended September 30, 2008 from the same period last year. Trade volume was 8% lower for the three months ended September 30, 2008, from the same period last year, which reflected a lower level of stock trading. We recently discontinued a stock trading strategy that has been marginal for some time.

**Brokerage:** During the three months ended September 30, 2008, income before income taxes in our electronic brokerage segment increased 13%, compared with the third quarter of 2007, primarily reflecting higher revenues from commissions and execution fees. Pre-tax margin decreased to 47% for the quarter ended September 30, 2008, compared with 50% for the same period last year, reflecting: (1) lower net interest driven by market conditions, (2) lower other income from decreased payment for order flow programs on US options exchanges, (3) increased employee compensation and occupancy expenses, primarily from an acquisition that is being integrated and (4) \$2.5 million in bad debt expense resulting from extreme market conditions.

Commissions and execution fees increased 41% due to robust growth in transaction volume and customer accounts. Total daily average revenue trades ("DARTs") for cleared and execution-only customers increased 40% to 377,000 during the three months ended September 30, 2008, compared to 270,000 during the three months ended September 30, 2007. Cleared customer DARTs increased by 48%, to 338,000, over the same period. The number of customer accounts increased 19% over the year ago quarter and customer equity grew by 13% over the year ago quarter.

Annualized DARTs per average account were 814 in the third quarter of 2008 and annualized net revenue per average account was \$4,483, up 25% and 3%, respectively, over the same quarter last year.

**Nine months results:** IBG, Inc.'s diluted earnings per share increased 60% year to date compared to the same period last year, to \$1.76 for the nine months ended September 30, 2008 from \$1.10, on a pro forma basis, for the same period in 2007.

**Consolidated:** For the nine months ended September 30, 2008, our net revenues were \$1,420.8 million and income before income taxes and minority interest was \$980.7 million, compared to net revenues of \$1,070.7 million and income before income taxes and minority interest of \$662.9 million for the same period in 2007. Income before income taxes was 48% higher in the nine months ended September 30, 2008 compared to the same period last year; trading gains were 58% higher



## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

and commissions and execution fees were up by 46% for the same time period. Our pre-tax margin, for the nine months ended September 30, 2008, was 69%, compared to 62% for the same period in 2007.

**Market Making:** During the nine months ended September 30, 2008, income before income taxes in our market making segment increased 56%, compared with the nine months ended September 30, 2007, primarily reflecting higher trading gains. Pre-tax margin increased to 78% for the nine months ended September 30, 2008. The nine months ended September 30, 2008, and in particular the first and third quarters, were marked by a productive environment for market making, with high market volumes and high volatility. These conditions allowed us to leverage our automated trading and real-time risk management system. While market making trade volume for the nine months ended September 30, 2008 was down 3% compared to the same period last year, options and futures contract volume rose 20% and 49%, respectively.

**Brokerage:** During the nine months ended September 30, 2008, income before income taxes in our electronic brokerage segment increased 33%, compared with the same period in 2007, reflecting higher revenues from commissions and execution fees. Pre-tax margin increased to 47% for the nine months ended September 30, 2008, compared with 44% for the same period last year, reflecting leverage from automation and decreased payments to broker-dealer customers for order flow. The increase in commissions and execution fees was related to robust growth in transaction volume and customer accounts. DARTs for cleared and execution-only customers increased 41% to 352,000 during the nine months ended September 30, 2008, compared to 250,000 during the nine months ended September 30, 2007. Cleared customer DARTs increased over the same period by 53% to 309,000. The increase in net interest was driven by the growth in customer balances and fully-secured margin loans.

Market making, by its nature, does not produce predictable earnings. Our results in any given period may be materially affected by volumes in the global financial markets, the level of competition and other factors. Electronic brokerage is more predictable, but it is dependent on customer activity, growth in customer accounts and assets, interest rates and other factors. For a further discussion of the factors that may affect our future operating results, please see the description of risk factors in our Annual Report on Form 10-K filed with the SEC on March 27, 2008.

The following tables present historical trading volumes for our business. However, volumes are not the only drivers in our business.

### TRADE VOLUMES:

(in 000's, except %)

Period	Market Making		Brokerage Cleared		Brokerage Non Cleared		Total Trades	% Change	Avg. Trades per U.S. Trading
	Trades	% Change	Trades	% Change	Trades	% Change			
2003	32,772		22,748		2,367		57,887		230
2004	41,506	27%	28,876	27%	2,932	24%	73,314	27%	290
2005	54,044	30%	34,800	21%	7,380	152%	96,224	31%	382
2006	66,043	22%	51,238	47%	12,828	74%	130,109	35%	518
2007	99,086	50%	72,931	42%	16,638	30%	188,655	45%	752
3Q2007	27,203		19,092		3,878		50,173		796
3Q2008	25,045	-8%	32,840	72%	4,336	12%	62,221	24%	972

**CONTRACT AND SHARE VOLUMES:***(in 000's, except %)***TOTAL**

<b>Period</b>	<b>Options (contracts)</b>	<b>% Change</b>	<b>Futures* (contracts)</b>	<b>% Change</b>	<b>Stocks (shares)</b>	<b>% Change</b>
2003	194,358		31,034		17,038,250	
2004	269,715	39%	37,748	22%	17,487,528	3%
2005	409,794	52%	44,560	18%	21,925,120	25%
2006	563,623	38%	62,419	40%	34,493,410	57%
2007	673,144	19%	83,134	33%	47,324,798	37%
3Q2007	178,906		22,330		12,805,676	
3Q2008	205,470	15%	28,928	30%	14,489,937	13%

**MARKET MAKING**

<b>Period</b>	<b>Options (contracts)</b>	<b>% Change</b>	<b>Futures* (contracts)</b>	<b>% Change</b>	<b>Stocks (shares)</b>	<b>% Change</b>
2003	177,459		6,638		12,578,584	
2004	236,569	33%	10,511	58%	12,600,280	0%
2005	308,613	30%	11,551	10%	15,625,801	24%
2006	371,929	21%	14,818	28%	21,180,377	36%
2007	447,905	20%	14,520	-2%	24,558,314	16%
3Q2007	125,720		3,805		6,867,410	
3Q2008	138,294	10%	5,581	47%	6,145,983	-11%

**BROKERAGE TOTAL**

<b>Period</b>	<b>Options (contracts)</b>	<b>% Change</b>	<b>Futures* (contracts)</b>	<b>% Change</b>	<b>Stocks (shares)</b>	<b>% Change</b>
2003	16,898		24,396		4,459,667	
2004	33,146	96%	27,237	12%	4,887,247	10%
2005	101,181	205%	33,009	21%	6,299,319	29%
2006	191,694	89%	47,601	44%	13,313,033	111%
2007	225,239	17%	68,614	44%	22,766,484	71%
3Q2007	53,186		18,525		5,938,266	
3Q2008	67,176	26%	23,347	26%	8,343,954	41%

\*Includes options on futures

**CONTRACT AND SHARE VOLUMES, continued:**

*(in 000's, except %)*

**BROKERAGE CLEARED**

<b>Period</b>	<b>Options (contracts)</b>	<b>% Change</b>	<b>Futures* (contracts)</b>	<b>% Change</b>	<b>Stocks (shares)</b>	<b>% Change</b>
2003	11,351		19,086		3,612,503	
2004	16,438	45%	24,118	26%	4,339,462	20%
2005	23,456	43%	30,646	27%	5,690,308	31%
2006	32,384	38%	45,351	48%	12,492,870	120%
2007	51,586	59%	66,278	46%	20,353,584	63%
3Q2007	13,637		17,844		5,217,253	
3Q2008	22,790	67%	22,892	28%	7,421,039	42%

\* Includes options on futures

**BROKERAGE STATISTICS:**

*(in 000's, except % and where noted)*

	<b>3Q2008</b>	<b>3Q2007</b>	<b>% Change</b>
Total Accounts	107	90	19%
Customer Equity (in billions) *	\$ 9.4	\$ 8.3	13%
Cleared DARTs	338	228	48%
Total Customer DARTs	377	270	40%

*(in \$'s, except DART per account)*

	<b>3Q2008</b>	<b>3Q2007</b>
Commission per DART	\$ 4.21	\$ 4.58
DART per Avg. Account (Annualized)	814	652
Net Revenue per Avg. Account (Annualized)	\$ 4,483	\$ 4,344

\* Excludes non-customers (i.e., officers, directors and affiliated parties)

**Business Environment**

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

In the third quarter we witnessed heightened turbulence in the financial sector due to continued tightening of the credit markets, coupled with the announced failures and restructuring of large financial institutions and increased levels of federal government intervention. We have been relatively unaffected by these events. We do not hold any mortgage-backed securities or credit default swaps, which have led to massive losses across the financial sector. With the exception of spot foreign exchange, we trade and broker only exchange-listed financial instruments with a ready market and clearly determinable values. Our positions are marked-to-market every day using external closing prices published by the exchanges and clearing houses, so there is no subjective judgment used in valuing these assets.

The recent turmoil has brought historic levels of volatility and unprecedented losses across global financial markets. Despite the challenges this has brought for many broker-dealers, we continued to enjoy healthy profit growth in both our brokerage and market making businesses.

Our brokerage business continues to grow at a strong pace. Our recent marketing efforts have focused on highlighting the safety and stability of our firm. This distinction is based on our strong capital base of over \$4 billion and our state of the art risk management system which was designed to curtail the risk of substantial bad debt losses. Our advanced Credit Manager System alerts customers when they approach margin violations and, if necessary, we automatically liquidate positions on a real-time basis to bring the customer's account into margin compliance. This protects our company and our

customers from excessive losses and is especially important during times of violent market swings as we have seen in recently. Other brokers-dealers may extend margin credit to their customers for up to three days, putting the company at risk for large customer losses they may not be able to absorb. In this current environment, we believe customers understand this potential risk and we have seen positive feedback in the form of customer account growth.

This turbulent environment is also productive for our market making business, which is fueled by high levels of market volatility and trading volumes. We have also benefited from a reduction in the level of competition during the third quarter. Although this phenomenon is cyclical, we have observed that during times of heightened market volatility, there is less activity by so called "high frequency traders" in the U.S. options markets. These traders utilize computerized algorithms to employ strategies to profit from certain advantages they have over market makers, including using their customer status to avoid exchange fees and to enjoy execution priority.

Another driver of our market making profits is the relationship between actual and implied volatility in the equities markets. The cost of maintaining our conservative risk profile is based on implied volatility, while our profitability, in part, is based on actual volatility. Hence, our profitability is increased when actual volatility runs above implied volatility and it is decreased when actual volatility falls below implied volatility. Implied volatility tends to lag actual volatility, as observed in the shifts during the first three quarters of 2008. While actual volatility was roughly equal to implied volatility in the first quarter, it slipped below implied volatility in the second quarter. This was reflected in the drop in our second quarter profitability from market making. However, in the third quarter, actual volatility was greater than implied volatility, which is evidenced in our market making profits. This kind of cycle has been a regular pattern in the markets historically.

Despite the downturn in global markets this year, option volumes continue to climb. According to data compiled by the Futures Industry Association (FIA) and based on data received from exchanges worldwide, volumes in exchange-listed equity-based options increased by approximately 25.8% globally and 35.4% in the U.S. during the nine months ended September 30, 2008, compared to the same period in 2007. This is a continuation of a trend we have observed over the past six years, and we believe that as the "equity culture" spreads around the world this trend is likely to continue.

According to these same sources, in the third quarter of 2008, we accounted for approximately 13.0% of the exchange-listed equity options volume traded worldwide and approximately 16.0% of exchange-listed equity options volume traded in the U.S. This compares to approximately 14.2% of the exchange-listed equity options volume traded worldwide and approximately 18.1% of the exchange-listed equity options volume traded in the U.S. in the third quarter of 2007.

**Results of Operations**

The tables in the period comparisons below provide summaries of our revenues and expenses. The period-to-period comparisons of financial results are not necessarily indicative of future results. Historical results of operations are reported as a limited liability company until the IPO, which occurred on May 4, 2007, and do not include franchise tax, minority interest, and federal and state income taxes. Such items are included in subsequent periods. Therefore, the historical results for the period prior to the IPO and subsequent thereto are not comparable. This MD&A includes certain pro forma financial data to present our results of operations on a more comparable basis.

The following table sets forth our consolidated results of operations for the indicated periods:

	<b>Three Months</b>		<b>Nine Months</b>	
	<b>Ended September 30, 2008</b>	<b>2007</b>	<b>Ended September 30, 2008</b>	<b>2007</b>
<b>(in millions except share and per share data)</b>				
<b>Revenues:</b>				
Trading gains	\$ 361.4	\$ 289.2	\$ 1,006.0	\$ 638.3
Commissions and execution fees	98.2	69.5	271.9	186.1
Interest income	101.1	207.6	373.8	597.2
Other income	7.1	21.6	55.6	68.9
<b>Total revenues</b>	<b>567.8</b>	<b>587.9</b>	<b>1,707.3</b>	<b>1,490.5</b>
Interest expense	70.8	142.8	286.5	419.8
<b>Total net revenues</b>	<b>497.0</b>	<b>445.1</b>	<b>1,420.8</b>	<b>1,070.7</b>
<b>Non-interest expenses:</b>				
Execution and clearing	82.9	85.1	244.0	256.7
Employee compensation and benefits	39.5	31.0	119.4	92.7
Occupancy, depreciation and amortization	10.5	6.7	27.6	19.1
Communications	4.8	4.1	13.4	11.0
General and administrative	11.9	10.3	35.7	28.3
<b>Total non-interest expenses</b>	<b>149.6</b>	<b>137.2</b>	<b>440.1</b>	<b>407.8</b>
<b>Income before income taxes and minority interest</b>	<b>347.4</b>	<b>307.9</b>	<b>980.7</b>	<b>662.9</b>

Certain actual and pro forma information with respect to the periods described above is presented below. Information for the three month periods ended September 30, 2008 and 2007, as well as, the nine month period ended September 30, 2008 is based on actual results and the nine month period ended September 30, 2007 is presented as if we had been a public company for the entire period.

	<b>Actual</b>	<b>Actual</b>	<b>Actual</b>	<b>Pro Forma <sup>(1)</sup></b>
Income tax expense <sup>(2)</sup>	32.4	27.3	94.4	48.2
Minority interest <sup>(3)</sup>	287.8	258.4	813.6	569.4
<b>Net income</b>	<b>\$ 27.2</b>	<b>\$ 22.2</b>	<b>\$ 72.7</b>	<b>\$ 45.3</b>

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

<b>Earnings per share <sup>(4)</sup></b>				
Basic	\$ 0.67	\$ 0.55	\$ 1.80	\$ 1.13
Diluted	\$ 0.65	\$ 0.53	\$ 1.76	\$ 1.10
<b>Weighted average common shares outstanding</b>				
Basic	40,602,515	40,142,196	40,386,579	40,142,196
Diluted	399,112,085	401,315,481	400,180,439	401,317,851



- (1) The unaudited pro forma consolidated statement of income for the nine month period ended September 30, 2007, gives pro forma effect to the recapitalization, and the consummation of our initial public offering and our application of the net proceeds from the offering to purchase membership interests in IBG LLC from IBG Holdings as though such transactions had occurred on January 1, 2007. Pro forma earnings per share calculation includes (i) restricted shares of Common Stock that have been issued or are to be issued pursuant to the 2007 ROI Unit Stock Plan and (ii) issuance of restricted shares of Common Stock pursuant to the 2007 Stock Incentive Plan, but excludes shares of Common Stock that are issuable in the future pursuant to the 2007 Stock Incentive Plan.
- (2) Subsequent to the IPO, additional deferred income tax expense is \$25.4 million, calculated on a straight line basis, resulting from the amortization of the deferred tax asset of \$380.8 million arising from the acquisition of the 10.0% member interest in IBG LLC over 15 years. Of this amount, \$13.1 million would have been amortizable for the nine month period ended September 30, 2007, under current tax law. This additional deferred income tax expense is, however, fully offset by reduced current income tax expense in calculating the total provision for income taxes.
- (3) The pro forma period presented is adjusted for the approximate 89.7% interest in IBG LLC that IBG Holdings LLC holds arising from the Recapitalization and the IPO, including initial share issuances pursuant to employee equity incentive plans (see note 1 above). The adjustment is equal to approximately 89.7% of IBG LLC's total net income for the period presented.
- (4) Pro forma basic earnings per share were calculated based on 40.1 million shares of Common Stock and 100 shares of Class B common stock outstanding. Pro forma diluted earnings per share were calculated based on an assumed purchase by us of all remaining IBG LLC membership interests held by IBG Holdings LLC and the issuance by us of 360 million shares of Common Stock, resulting in a total of 401.3 million shares deemed outstanding as of the beginning of the period. There is no impact on earnings per share for such purchase and issuance because 100% of net income before minority interest would be available to common stockholders as IBG Holdings LLC would no longer hold a minority interest, and the full difference between the book and tax basis of IBG LLC's assets would also be available for reducing income tax expense. Therefore, the pro forma net income utilized to calculate diluted earnings per share would be \$440 million for the nine month period ended September 30, 2007.

Diluted weighted average common shares outstanding include 1.2 million shares of Common Stock to be issued pursuant to the 2007 ROI Unit Stock Plan. Shares of Common Stock to be issued in connection with the 2007 Stock Incentive Plan have been excluded from diluted weighted average common shares outstanding because such shares are non-dilutive.

**Three Months Ended September 30, 2008 Compared to the Three Months Ended September 30, 2007*****Net Revenues***

Total net revenues for the three months ended September 30, 2008 increased \$51.9 million, or 12%, to \$497.0 million from \$445.1 million, during the three months ended September 30, 2007. Trading volume is one of the most important drivers of revenues and costs for both our market making and electronic brokerage segments. Based on data published by the FIA and options exchanges worldwide, in the third quarter of 2008 global equity options volume increased approximately 27%, compared to the third quarter of 2007. For the three months ended September 30, 2008, equity-based option contracts executed by our subsidiaries increased by 26.6 million, or 15%, to 205.5 million contracts from 178.9 million contracts for the three months ended September 30, 2007.

*Trading Gains.* Trading gains for the three months ended September 30, 2008 increased \$72.2 million, or 25%, to \$361.4 million from \$289.2 million for the three months ended September 30, 2007. As market makers, we provide liquidity by buying from sellers and selling to buyers. Market making options and futures contract volume in the quarter ended September 30, 2008 increased by 10% and 47%, respectively, from the same period in 2007. However, our stock volume experienced an 11% decline in the quarter ended September 30, 2008 from the same period in 2007. We recently discontinued a stock trading strategy we had used to provide more liquidity for stocks. That strategy had been marginal for some time and has been replaced by another one that has been updated to take advantage of the new trading rules and payment models on the U.S. exchanges.

Included in trading gains are net dividends and currency translation gains and losses from market making activities. Dividend income and expense arise from holding market making positions over dates on which dividends are paid to shareholders of record. When a stock pays a dividend, its market price is generally adjusted downward to reflect the value paid to the shareholders of record, which will not be received by those who purchase stock after the ex-dividend date. Hence, the apparent gains and losses due to these price changes must be taken together with the dividends paid and received, respectively, in order to accurately reflect the results of our market making operations. As part of managing our overall exposure to foreign currency fluctuations, we maintain a portion of our capital in foreign currencies. Translation gains of \$9.2 million were recognized in the three months ended September 30, 2008, on foreign currency balances held by our subsidiaries, compared to translation gains of \$15.4 million for the three months ended September 30, 2007. A discussion of our approach to managing foreign currency exposure is contained in Part 1, Item 3 of this Quarterly Report on Form 10-Q entitled "Quantitative and Qualitative Disclosures about Market Risk."

*Commissions and Execution Fees.* Commissions and execution fees for the three months ended September 30, 2008 increased \$28.7 million, or 41%, to \$98.2 million, as compared to the three months ended September 30, 2007. This increase was primarily due to higher customer trading volume on an expanded customer base. Total DARTs for cleared and execution-only customers for the three months ended September 30, 2008 increased 40% to 377,000 compared to 270,000 during the three months ended September 30, 2007. DARTs for cleared customers, i.e., customers for whom we execute trades as well as clear and carry positions, increased 48% to approximately 338,000, for the three months ended September 30, 2008, compared to approximately 228,000 for the three months ended September 30, 2007. The number of customer accounts grew by 19% to approximately 107,000 at September 30, 2008, compared to approximately 90,000 at September 30, 2007. Average commission per DART for cleared customers, for the three months ended September 30, 2008, decreased by \$0.37, or 8%, to \$4.21, as compared to \$4.58 for the three months ended September 30, 2007, primarily due to more frequently trading customers who qualify for lower commissions on our sliding commissions scale.

*Interest Income and Interest Expense.* Net interest income (interest income less interest expense) for the three months ended September 30, 2008 decreased \$34.5 million, or 53%, to \$30.3 million, as compared to the three months ended September 30, 2007. Net interest income from market making, which accounted for 31% of total net interest income, contracted to \$9.3 million, a decrease of 79% from the same period last year. As a result of the way we have integrated our market making and securities lending systems, our trading income and our net interest income are interchangeable and depend on the mix of market making positions in our portfolio. When implied interest rates in the equity and equity options and futures markets exceed the actual interest rates available to us, our market making systems tend to buy stock and sell it forward, which produces higher trading gains and lower net interest income. When these rates are inverted, our market making systems tend to sell stock and buy it forward, which produces lower trading gains and higher net interest income. The relative interest rates during the third quarter of 2008 resulted in a mix of positions that produced more trading income and less interest income. In addition, average securities borrowed decreased by 42%, to \$5.06 billion, and average securities loaned decreased by 51%, to \$2.52 billion, for the quarter ended September 30, 2008, as market making positions contracted. Customer cash balances increased by 9%, to \$7.0 billion, end-of-period, and customer fully secured margin borrowings increased 39%, to \$1.83 billion, end-of-period, at

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

September 30, 2008, as compared to \$6.45 billion and \$1.32 billion, end-of-period, respectively, at September 30, 2007. Customer cash balances at September 30, 2008 include approximately \$0.13 billion from director and officer account balances. Lower interest rates have had a negative effect on the net interest income we earned on small customer cash balances. The average Fed Funds effective rate dropped 314 basis points to 1.94% for the quarter ended September 30, 2008 as compared to 5.08% for the quarter ended September 30, 2007. Net interest earned in electronic brokerage decreased \$1.8 million, or 8%, to \$20.0 million, as compared to the three months ended September 30, 2007.

*Other Income.* Other income, for the three months ended September 30, 2008, decreased \$14.5 million, or 67%, as compared to the three months ended September 30, 2007. This decrease was primarily attributable to a \$10.0 million write down in our equity investment in W.R. Hambrecht + Co. Inc. and a \$3.5 million decrease in payment for order flow income received by our brokerage unit, primarily due to the penny pricing pilot which was introduced in February of 2007 and extended to 63 options classes in March 2008.

### ***Non-Interest Expenses***

Non-interest expenses, for the three months ended September 30, 2008, increased by \$12.4 million, or 9%, to \$149.6 million from \$137.2 million, during the three months ended September 30, 2007. Execution and clearing expenses made up 55% and employee compensation and benefits were 26% of non-interest expenses. As a percentage of total net revenues, non-interest expenses declined to 30% for the three month period ended September 30, 2008 from 31% during the same period in 2007.

*Execution and Clearing.* Execution and clearing expenses, for the three months ended September 30, 2008, decreased \$2.2 million, or 3%, to \$82.9 million, as compared to the three months ended September 30, 2007. This in part reflects the reduction in exchange-mandated payment-for-order-flow program costs as more options traded in pennies, as well as, greater options volume being executed on exchanges that use the maker/taker model, where, as a market maker we are paid for providing liquidity instead of paying exchange fees. This was partially offset by increased expenses in our electronic brokerage unit which were in line with the increases in trade volumes. In prior quarters we spoke about cost savings associated with the reduction in payment to broker-dealer customers for order flow and the routing of more customer limit orders to options exchanges that pay for liquidity. These savings were already largely reflected in the numbers for 3rd quarter of 2007 comparative period.

*Employee Compensation and Benefits.* Employee compensation and benefits expenses, for the three months ended September 30, 2008, increased by \$8.5 million, or 27%, to \$39.5 million, as compared to the three months ended September 30, 2007. This increase reflected the continued phase-in of expenses related to our employee stock incentive plan and a 26% average growth in the number of employees to 730 at September 30, 2008, as compared to 586 at September 30, 2007, in large part due to the addition of approximately 60 new staff members from our acquisition of FutureTrade Technologies, LLC. As we continue to grow, our focus on automation has allowed us to maintain a relatively small staff. As a percentage of total net revenues, employee compensation and benefits expenses were 8% and 7%, for the three month periods ended September 30, 2008 and 2007, respectively.

*General and Administrative.* General and administrative expenses, for the three months ended September 30, 2008, increased \$1.6 million, or 16%, as compared to the three months ended September 30, 2007, primarily attributable to increased advertising expenditures and customer reserves, partially offset by a reduction in professional services.

### **Nine Months Ended September 30, 2008 Compared to the Nine Months Ended September 30, 2007**

#### ***Net Revenues***

Total net revenues for the nine months ended September 30, 2008 increased \$350.1 million, or 33%, to \$1,420.8 million from \$1,070.7 million, during the nine months ended September 30, 2007. Trading volume is one of the most important drivers of revenues and costs for both our market making and electronic brokerage segments. Based on data published by the FIA and options exchanges worldwide, global equity options volume in the first nine months of 2008 increased approximately 25.8%, compared to the first nine months of 2007. For the nine months ended September 30, 2008, options contracts executed by our subsidiaries increased by 88.3 million, or 18%, to 579.6 million contracts from 491.3 million contracts for the nine months ended September 30, 2007.



*Trading Gains.* Trading gains for the nine months ended September 30, 2008 increased \$367.7 million, or 58%, to \$1,006.0 million from \$638.3 million for the nine months ended September 30, 2007. As market makers, we provide liquidity by buying from sellers and selling to buyers. During the nine months ended September 30, 2008, our market making operations executed 72.0 million trades, which was down 3% compared to the number of trades executed in the nine months ended September 30, 2007. Market making options contract volume in the nine months ended September 30, 2008 increased by 20% from the same period in 2007.

Included in trading gains are net dividends and currency translation gains and losses from market making activities. As stated above, the apparent gains and losses due to these price changes, reflecting the value of dividends paid to shareholders, must be taken together with the dividends paid and received, respectively, in order to accurately reflect the results of our market making operations. As part of managing our overall exposure to foreign currency fluctuations, we maintain a portion of our capital in foreign currencies. Translation gains of \$10.4 million were recognized in the nine months ended September 30, 2008, on foreign currency balances held by our subsidiaries, compared to translation gains of \$41.8 million for the nine months ended September 30, 2007. A discussion of our approach to managing foreign currency exposure is contained in Part 1, Item 3 of this Quarterly Report on Form 10-Q entitled "Quantitative and Qualitative Disclosures about Market Risk."

*Commissions and Execution Fees.* Commissions and execution fees for the nine months ended September 30, 2008 increased \$85.8 million, or 46%, to \$271.9 million, as compared to the nine months ended September 30, 2007. This increase was primarily due to higher customer trading volume on an expanded customer base. Total DARTs for cleared and execution-only customers for the nine months ended September 30, 2008 increased 41% to 352,000, compared to 250,000 during the nine months ended September 30, 2007. DARTs for cleared customers, i.e., customers for whom we execute trades as well as clear and carry positions, increased 53% to approximately 309,000, for the nine months ended September 30, 2008, compared to approximately 202,000 for the nine months ended September 30, 2007. The number of customer accounts grew by 19% to approximately 107,000 at September 30, 2008, compared to approximately 90,000 at September 30, 2007. Average commission per DART for cleared customers, for the nine months ended September 30, 2008, decreased by \$0.43, or 9%, to \$4.27, as compared to \$4.70 for the nine months ended September 30, 2007, primarily due to more frequently trading customers who qualify for lower commissions on our sliding commissions scale.

*Interest Income and Interest Expense.* Net interest income (interest income less interest expense) for the nine months ended September 30, 2008 decreased \$90.1 million, or 51%, to \$87.3 million, as compared to the nine months ended September 30, 2007. Net interest income from market making, which accounted for 31% of total net interest income, contracted to \$26.8 million, a decrease of 78% from the same period last year. As a result of the way we have integrated our market making and securities lending systems, our trading income and our net interest income are interchangeable and depend on the mix of market making positions in our portfolio. When implied interest rates in the equity and equity options and futures markets exceed the actual interest rates available to us, our market making systems tend to buy stock and sell it forward, which produces higher trading gains and lower net interest income. When these rates are inverted, our market making systems tend to sell stock and buy it forward, which produces lower trading gains and higher net interest income. The relative interest rates during the first quarter of 2008 resulted in a mix of positions that produced more trading income and less interest income. In addition, average securities borrowed decreased by 40%, to \$5.66 billion and average securities loaned decreased by 47%, to \$3.29 billion, for the nine months ended September 30, 2008, as market making positions contracted. Customer cash balances increased by 9%, to \$7.0 billion, end-of-period, and customer fully secured margin borrowings increased 39%, to \$1.83 billion, end-of-period, at September 30, 2008, as compared to \$6.45 billion and \$1.32 billion, end-of-period, respectively, at September 30, 2007. Customer cash balances at September 30, 2008 include approximately \$0.13 billion from director and officer account balances. Lower interest rates have had a negative effect on the net interest income we earned on small customer cash balances. The average Fed Funds effective rate dropped 279 basis points to 2.40% for the nine months ended September 30, 2008 as compared to 5.19% for the nine months ended September 30, 2007. Net interest earned in electronic brokerage increased \$2.5 million, or 4%, to \$63.0 million, as compared to the nine months ended September 30, 2007.

*Other Income.* Other income, for the nine months ended September 30, 2008, decreased \$13.3 million, or 19%, as compared to the nine months ended September 30, 2007. This decrease was primarily attributable to a \$10.0 million write down in our equity investment in W.R. Hambrecht + Co. Inc. and a \$9.5 million decrease in payment for order flow income received by our brokerage unit, primarily due to the penny pricing pilot which was introduced in February 2007 and extended to 63 options classes in March 2008. These were offset by a \$4.4 million increase in mark-to-market gains on non-trading investments, which are predominately investments in exchanges and a \$4.2 million increase in market data fee income.

***Non-Interest Expenses***

Non-interest expenses, for the nine months ended September 30, 2008, increased by \$32.3 million, or 8%, to \$440.1 million from \$407.8 million, during the nine months ended September 30, 2007. Execution and clearing expenses made up 55% and employee compensation and benefits were 27% of non-interest expenses. As a percentage of total net revenues, non-interest expenses declined to 31% for the nine month period ended September 30, 2008 from 38% during the same period in 2007.

*Execution and Clearing.* Execution and clearing expenses, for the nine months ended September 30, 2008, decreased \$12.7 million, or 5%, to \$244.0 million, as compared to the nine months ended September 30, 2007. Execution and clearing expenses, outside of payment for order flow expenses, increased by \$9.7 million, or 4%, to \$231.3 million primarily due to increased trading volume across the markets in which the Group and its customers traded. Payments to order flow customers, a component of execution and clearing costs, for the nine months ended September 30, 2008, decreased by \$22.4 million, or 64%, to \$12.7 million, as compared to the nine months ended September 30, 2007. The decrease was attributable to discontinued servicing, which took place at the end of the second quarter in 2007, of certain non-cleared broker-dealer customers who received payment for order flow, and had a positive impact on our operating margins in the nine months ended September 30, 2008. Payment for order flow expense was partially offset by payment for order flow revenue received from U.S. options exchanges, as described above under "Net Revenues—Other Income."

*Employee Compensation and Benefits.* Employee compensation and benefits expenses, for the nine months ended September 30, 2008, increased by \$26.7 million, or 29%, to \$119.4 million, as compared to the nine months ended September 30, 2007. This increase reflected the continued phase-in of expenses related to our employee stock incentive plan and the 26% average growth in the number of employees to 730 at September 30, 2008, as compared to 586 at September 30, 2007, in large part due to the addition of approximately 60 new staff members from our acquisition of FutureTrade Technologies, LLC, which closed in December 2007. As we continue to grow, our focus on automation has allowed us to maintain a relatively small staff. As a percentage of total net revenues, employee compensation and benefits expenses were 8% and 9%, for the nine month periods ended September 30, 2008 and 2007, respectively.

*General and Administrative.* General and administrative expenses, for the nine months ended September 30, 2008, increased \$7.4 million, or 26%, as compared to the nine months ended September 30, 2007, primarily attributable to increases in increased advertising expenditures, reserves for customer debts and legal contingencies.

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

**Business Segments**

The following table sets forth the net revenues and non-interest expenses and income before income taxes of our business segments:

		Three Months		Nine Months	
		Ended September 30, 2008	2007	Ended September 30, 2008	2007
(in millions)					
<b>Market Making</b>	Net revenues	\$ 359.7	\$ 329.5	\$ 1,034.7	\$ 752.2
	Non-interest expenses	76.6	84.4	228.7	236.6
	Income before income taxes	283.1	\$ 245.1	\$ 806.0	\$ 515.6
	Pre-tax profit margin	79%	74%	78%	69%
<b>Electronic Brokerage</b>	Net revenues	\$ 134.6	\$ 111.7	\$ 387.1	\$ 307.0
	Non-interest expenses	70.7	55.4	206.1	171.2
	Income before income taxes	\$ 63.9	\$ 56.3	\$ 181.0	\$ 135.8
	Pre-tax profit margin	47%	50%	47%	44%
<b>Corporate*</b>	Net revenues	\$ 2.7	\$ 3.9	(\$1.0)	\$ 11.5
	Non-interest expenses	2.3	(2.6)	5.3	(0.0)
	Income before income taxes	\$ 0.4	6.5	(\$6.3)	\$ 11.5
<b>Total</b>	Net revenues	\$ 497.0	\$ 445.1	\$ 1,420.8	\$ 1,070.7
	Non-interest expenses	149.6	137.2	440.1	407.8
	Income before income taxes and minority interest	\$ 347.4	\$ 307.9	\$ 980.7	\$ 662.9
	Pre-tax profit margin	70%	69%	69%	62%

\* Corporate included corporate related activities as well as inter-segment eliminations

The following sections discuss results of our operations by business segment, excluding a discussion of corporate income and expense. In the following tables, revenues and expenses directly associated with each segment are included in determining income before income taxes. Due to the integrated nature of the business segments, estimates and judgments have been made in allocating certain revenue and expense items. Transactions between segments generally result from one subsidiary facilitating the business of another subsidiary through the use of its existing trading memberships and clearing arrangements. In such cases, certain revenue and expense items are eliminated in order to accurately reflect the external business conducted in each segment. Rates on transactions between segments are designed to approximate full costs. In addition to execution and clearing expenses, which are the main cost driver for both the market making segment and the electronic brokerage segment, each segment's operating expenses include (i) employee compensation and benefits expenses that are incurred directly in support of the businesses, (ii) general and administrative expenses, which include directly incurred expenses for property leases, professional fees, travel and entertainment, communications and information services, equipment, and (iii) indirect support costs (including compensation and other related operating expenses) for administrative services provided by IBG LLC. Such administrative services include, but are not limited to, computer software development and support, accounting, tax, legal and facilities management.





**Market Making**

The following table sets forth the results of our market making operations for the indicated periods:

	Three Months		Nine Months	
	Ended September 30,		Ended September 30,	
	2008	2007	2008	2007
	(in millions)			
<b>Revenues:</b>				
Trading gains	\$ 348.9	\$ 281.5	\$ 988.4	\$ 618.8
Interest income	49.4	124.9	200.4	387.9
Other income	1.5	3.8	19.5	11.4
Total revenues	399.8	410.2	1,208.3	1,018.1
Interest expense	40.1	80.7	173.6	265.9
Total net revenues	359.7	329.5	1,034.7	752.2
<b>Non-interest expenses:</b>				
Execution and clearing	48.0	57.1	140.6	159.3
Employee compensation and benefits	14.6	13.7	44.6	38.6
Occupancy, depreciation and amortization	0.8	2.9	6.7	8.4
Communications	2.8	2.2	7.7	5.7
General and administrative	10.4	8.5	29.1	24.6
Total non-interest expenses	76.6	84.4	228.7	236.6
<b>Income before income taxes</b>	<b>\$ 283.1</b>	<b>\$ 245.1</b>	<b>\$ 806.0</b>	<b>\$ 515.6</b>

**Three Months Ended September 30, 2008 Compared to the Three Months Ended September 30, 2007**

Market making total net revenues for the three months ended September 30, 2008 increased \$30.2 million, or 9%, to \$359.7 million, from \$329.5 million during the three months ended September 30, 2007. Trading gains for the three months ended September 30, 2008 increased \$67.4 million, or 24%, primarily due to increased market volumes and higher actual volatility relative to implied volatility. Market making options contract volume in the quarter ended September 30, 2008 increased by 10% from the same period in 2007 driven by higher industry volume and our ability to compete effectively in volatile markets. Trading gains also include translation gains and losses. Translation losses, for the three months ended September 30, 2008, were \$0.3 million, as compared to translation gains of \$9.6 million, for the three months ended September 30, 2007. Net interest income, for the three months ended September 30, 2008, decreased \$34.9 million, or 79%. As described above, our trading income and our net interest income are interchangeable and depend on the mix of market making positions in our portfolio and on the relative interest rates in the stock and options markets. For the third quarter of 2008 these factors produced more trading income and less interest income.

Market making non-interest expenses for the three months ended September 30, 2008 decreased \$7.8 million, or 9%, as compared to the three months ended September 30, 2007. Execution and clearing expenses decreased \$9.1 million, or 16%, from the same period in 2007, reflecting the reduction in exchange mandated payment for order flow program costs as more options traded in pennies. In addition, greater options volume was executed on U.S. option exchanges that use the make-or-take

model, where as a market maker we are paid for providing liquidity instead of paying exchange fees. This was partially offset by a \$0.9 million increase in employee compensation and benefits expenses, an increase of 7% from the three months ended September 30, 2007, reflecting the continued phase in of expenses related to our employee stock incentive plan. As a percentage of total net revenues, market making non-interest expenses decreased to 21% from 26% for the three months ended September 30, 2008 and 2007, respectively. Occupancy expense decreased due to a reallocation of expense to the Electronic Brokerage segment as that business expands.

#### **Nine months Ended September 30, 2008 Compared to the Nine months Ended September 30, 2007**

Market making total net revenues for the nine months ended September 30, 2008 increased \$282.5 million, or 38%, to \$1,034.7 million, from \$752.2 million during the nine months ended September 30, 2007. Trading gains for the nine months ended September 30, 2008 increased \$369.6 million, or 60%, primarily due to increased market volumes and high actual volatility in market prices relative to implied volatility in options prices in the first and third quarter of 2008. Market making options contract volume in the nine months ended September 30, 2008 increased by 20% from the same period in 2007, driven by favorable market conditions. Trading gains also include translation gains and losses. Translation losses, for the nine months ended September 30, 2008, were \$2.0 million, as compared to translation gains of \$32.3 million, for the nine months ended September 30, 2007. Net interest income, for the nine months ended September 30, 2008, decreased \$95.2 million, or 78%. As described above, our trading income and our net interest income are interchangeable and depend on the mix of market making positions in our portfolio and on the relative interest rates in the stock and options markets. For the first nine months of 2008 these factors produced more trading income and less interest income.

Market making non-interest expenses for the nine months ended September 30, 2008 decreased \$7.9 million, or 3%, as compared to the nine months ended September 30, 2007. This small change resulted from a \$18.7 million decrease in execution and clearing costs offset by a \$6.0 million increase in employee compensation and benefits expenses and a \$4.5 million increase in general and administrative expenses. The 12% decrease in execution and clearing expenses reflects the reduction in exchange mandated payment for order flow program costs as more options are traded in pennies. In addition, greater options volume was executed on U.S. option exchanges that use the make-or-take model, where as a market maker we are paid for providing liquidity instead of paying exchange fees. As a percentage of total net revenues, market making non-interest expenses decreased to 22% from 31% for the nine months ended September 30, 2008 and 2007, respectively.

Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

**Electronic Brokerage**

The following table sets forth the results of our electronic brokerage operations for the indicated periods:

	<b>Three Months Ended September 30, 2008</b>		<b>Nine Months Ended September 30, 2008</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
	<b>(in millions)</b>			
<b>Revenues:</b>				
Commissions and execution fees	\$ 98.2	\$ 69.5	\$ 271.9	\$ 186.1
Interest income	52.9	87.7	181.9	222.9
Other income	16.4	20.4	52.2	60.4
<b>Total revenues</b>	<b>167.5</b>	<b>177.6</b>	<b>506.0</b>	<b>469.4</b>
Interest expense	32.9	65.9	118.9	162.4
<b>Total net revenues</b>	<b>134.6</b>	<b>111.7</b>	<b>387.1</b>	<b>307.0</b>
<b>Non-interest expenses:</b>				
Execution and clearing	36.1	28.6	104.7	97.9
Employee compensation and benefits	11.8	9.7	36.3	27.4
Occupancy, depreciation and amortization	5.8	1.9	12.4	5.1
Communications	2.0	1.9	5.7	5.2
General and administrative	15.0	13.3	47.0	35.6
<b>Total non-interest expenses</b>	<b>70.7</b>	<b>55.4</b>	<b>206.1</b>	<b>171.2</b>
<b>Income before income taxes</b>	<b>\$ 63.9</b>	<b>\$ 56.3</b>	<b>\$ 181.0</b>	<b>\$ 135.8</b>

**Three Months Ended September 30, 2008 Compared to the Three Months Ended September 30, 2007**

Electronic brokerage total net revenues for the three months ended September 30, 2008 increased \$22.9 million, or 21%, to \$134.6 million, from \$111.7 million during the three months ended September 30, 2007, primarily due to higher commissions and execution fees, which increased \$28.7 million, or 41%. This increase reflects strong growth in the number of new customer accounts and significantly higher customer trading activity. Total DARTs from cleared and execution-only customers for the three months ended September 30, 2008 increased 40% to 377,000, compared to 270,000 during the three months ended September 30, 2007. DARTs from cleared customers for the three months ended September 30, 2008 increased 48% to 338,000, compared to 228,000 during the three months ended September 30, 2007. Net interest decreased by \$1.8 million, or 8%, to \$20.0 for the three months ended September 30, 2008 due to lower benchmark interest rates and greater spreads in the foreign currency swap markets we use to convert foreign currency customer deposits to US dollar denominated safekeeping deposits for regulatory compliance. Total customer account equity grew by 13% to \$9.4 billion at September 30, 2008, from \$8.3 billion at September 30, 2007, excluding approximately \$0.66 billion from director and officer accounts at September 30, 2008. The primary component of other income, payment for order flow received through programs administered by U.S. options exchanges, decreased \$3.6 million, or 22%, and it was partially offset by the reductions in payment for order flow expense.

Electronic brokerage non-interest expenses for the three months ended September 30, 2008 increased \$15.3 million, or 28%, as compared to the three months ended September 30, 2007. Within that, execution and clearing expenses increased by \$7.5 million, which was comprised of an increase of \$9.3 million in trade execution and clearing expenses partially offset by a \$1.8 million reduction in payment for order flow expense in the three months ended September 30, 2008, as compared to the three months ended September 30, 2007. Employee compensation and benefits expenses, for the three months ended September 30, 2008, increased by \$2.1 million, or 22%, to \$11.8 million, as compared to the three months ended September 30, 2007. This increase was primarily due to a 35% growth in the number of employees due to our acquisition of FutureTrade Technologies, LLC and continuing growth in our customer service capabilities. Occupancy, depreciation and amortization increased by \$3.9 million, or 205%, due to a rent allocation adjustment to reflect the greater physical presence of the electronic brokerage business, made in the third quarter of 2008. General and administrative expenses increased by \$1.7 million, or 13%, primarily due to a \$2.5 million expense for bad debt. As a percentage of total net revenues, non-interest expenses increased to 53% from 50% for the three month

periods ended September 30, 2008 and 2007, respectively.

### **Nine Months Ended September 30, 2008 Compared to the Nine Months Ended September 30, 2007**

Electronic brokerage total net revenues for the nine months ended September 30, 2008 increased \$80.1 million, or 26%, to \$387.1 million, from \$307.0 million during the nine months ended September 30, 2007, primarily due to higher commissions and execution fees and net interest income, which increased \$85.8 million, or 46%, and \$2.5 million, or 4%, respectively. These increases reflect strong growth in the number of new customer accounts and significantly higher customer trading activity, combined with increases in customer cash and margin debit balances. Total DARTs from cleared and execution-only customers for the nine months ended September 30, 2008 increased 41% to 352,000, compared to 250,000 during the nine months ended September 30, 2007. DARTs from cleared customer's for the nine months ended September 30, 2008 increased 53% to 309,000, compared to 202,000 during the nine months ended September 30, 2007. Total customer account equity grew by 13% to \$9.4 billion at September 30, 2008, from \$8.3 billion at September 30, 2007, excluding approximately \$0.66 billion from director and officer accounts at September 30, 2008. The primary component of other income, payment for order flow received through programs administered by U.S. options exchanges, decreased \$9.5 million, or 20%, and it was partially offset by the reductions in payment for order flow expense.

Electronic brokerage non-interest expenses for the nine months ended September 30, 2008 increased \$34.9 million, or 20%, as compared to the nine months ended September 30, 2007. Within that, execution and clearing expenses increased by \$6.8 million, which was comprised of an increase of \$29.7 million in trade execution and clearing expenses partially offset by a \$22.9 million reduction in payment for order flow expense in the nine months ended September 30, 2008, as compared to the nine months ended September 30, 2007. Employee compensation and benefits expenses, for the nine months ended September 30, 2008, increased by \$8.9 million, or 32%, to \$36.3 million, as compared to the nine months ended September 30, 2007. This increase was primarily due to a 45% growth in the average number of employees due to our acquisition of FutureTrade Technologies, LLC and continuing growth in our customer service capabilities. General and administrative expenses increased by \$11.4 million, or 32%, primarily due to increased reserves for customer debts and for legal contingencies, as well as increased advertising expenses. As a percentage of total net revenues, non-interest expenses decreased to 53% from 56% for the nine month periods ended September 30, 2008 and 2007, respectively, reflecting the scalability of our automated brokerage platform.

### **Liquidity and Capital Resources**

We maintain a highly liquid balance sheet. The majority of our assets consist of exchange-listed marketable securities inventories, which are marked-to-market daily, and collateralized receivables arising from customer-related and proprietary securities transactions. Collateralized receivables consist primarily of securities borrowed, receivables from clearing houses for settlement of securities transactions and, to a lesser extent, customer margin loans and securities purchased under agreements to resell. At September 30, 2008, total assets were \$29.35 billion of which approximately \$28.85 billion, or 98.3%, were considered liquid and consisted of predominantly exchange-listed marketable securities and receivables collateralized by exchange-listed securities.

Daily monitoring of liquidity needs and available collateral levels is undertaken to help ensure that an appropriate liquidity cushion, in the form of unpledged collateral, is maintained at all times. Our ability to quickly reduce funding needs by balance sheet contraction without adversely affecting our core businesses and to pledge additional collateral in support of secured borrowings is continuously evaluated to ascertain the adequacy of our capital base.

In order to provide additional liquidity and to further increase our regulatory capital reserves, we issue senior notes and we maintain a committed senior secured revolving credit facility from a syndicate of banks (see "Principal Indebtedness" below). As of September 30, 2008, borrowings under these facilities totaled \$481.7 million, which represented 11% of IBG, LLC's total capitalization. Based on our current level of operations, we believe our cash flows from operations, available cash and available borrowings under our senior secured revolving credit facility will be adequate to meet our future liquidity needs beyond the next twelve months.

Historically, our consolidated equity has consisted primarily of accumulated retained earnings, which to date have been sufficient to fund our operations and growth. The consolidated equity of IBG LLC grew from \$3.26 billion at September 30, 2007 to \$4.08 billion at September 30, 2008, representing an increase of 25%.

### **Regulatory Capital Requirements**

Our principal operating subsidiaries are subject to separate regulation and capital requirements in the United States and other jurisdictions. Timber Hill LLC and Interactive Brokers LLC are registered U.S. broker-dealers and futures commission merchants, and their primary regulators include the SEC, the Commodity Futures Trading Commission, the Chicago Board



Options Exchange, the Chicago Mercantile Exchange, the Financial Industry Regulatory Authority and the National Futures Association. Timber Hill Europe AG is registered to do business in Switzerland as a securities dealer and is regulated by the Swiss Federal Banking Commission. Interactive Brokers (U.K.) Limited is subject to regulation by the U.K. Financial Services Authority and our various other operating subsidiaries are similarly regulated. See the Notes to the unaudited condensed consolidated financial statements in Part 1, Item 1 of this Quarterly Report on Form 10-Q for further information regarding our regulated subsidiaries.

### *Principal Indebtedness*

IBG LLC is the borrower under a \$300.0 million senior secured revolving credit facility and is the issuer of senior notes of which \$300.0 million and \$181.7 million, respectively, were outstanding as of September 30, 2008.

#### *Senior Secured Revolving Credit Facility*

On May 19, 2006, IBG LLC entered into a \$300.0 million three-year senior secured revolving credit facility with JPMorgan Chase Bank, N.A. as administrative agent, Harris N.A., as syndication agent, and Citibank, N.A. and HSBC Bank USA National Association, as co-syndication agents. IBG LLC is the sole borrower under this credit facility, which is required to be guaranteed by IBG LLC's domestic non-regulated subsidiaries (currently there are no such entities). The facility is secured by a first priority interest in all of the capital stock of each entity owned directly by IBG LLC (subject to customary limitations with respect to foreign subsidiaries). The facility may be used to finance working capital needs and general corporate purposes, including down streaming funds to IBG LLC's regulated broker-dealer subsidiaries as regulatory capital. This allows IBG LLC to take advantage of market opportunities when they arise, while maintaining substantial excess regulatory capital. The financial covenants contained in this credit facility are as follows:

- minimum net worth of \$1.5 billion, with quarterly increases equal to 25% of positive consolidated income;
- maximum total debt to capitalization ratio of 30%;
- minimum liquidity ratio of 1.0 to 1.0; and
- maximum total debt to net regulatory capital ratio of 35%.

As of September 30, 2008, IBG LLC was in compliance with all of the covenants under this credit facility.

#### *Senior Notes*

IBG LLC periodically issues senior notes in private placements to certain qualified customers of IB LLC. IBG LLC uses the proceeds from sales of the senior notes to provide capital to IBG LLC's broker-dealer subsidiaries in the form of subordinated loans and for other general purposes. The outstanding senior notes have a 7% per annum interest rate, and either a 15-month or an 18-month maturity. IBG LLC may, solely at its option, redeem the senior notes at any time on or after a specified date in the third month or the sixth month, respectively, after the date on which the senior notes are issued and sold, at a redemption price equal to 100% of the principal amount of the senior notes to be redeemed plus accrued interest.

At September 30, 2008 and December 31, 2007, IBG LLC had \$181.7 million and \$160.5 million, respectively, of senior notes outstanding. During the period from January 1 through September 30, 2008, total senior notes issued were \$382.7 million, and senior notes redeemed totaled \$361.5 million.

The senior notes are secured, as is the senior secured revolving credit facility, by a first priority interest in all of the capital stock of each entity owned directly by IBG LLC (subject to customary limitations with respect to foreign subsidiaries).

The senior notes contain covenants that may limit IBG LLC's ability to:

- incur, or permit its subsidiaries to incur, additional indebtedness;
- create, or permit its subsidiaries to create, liens on any capital stock or equity interests of its subsidiaries;





- declare and pay dividends or make other equity distributions; and
- consolidate, merge or sell all or substantially all of its assets.

**Cash Flows**

The following table sets forth our cash flows from operating activities, investing activities and financing activities for the periods indicated:

	<b>Nine Months Ended September 30,</b>	
	<b>2008</b>	<b>2007</b>
	<b>(in millions)</b>	
Cash provided by operating activities	\$ 800.2	\$ 205.5
Cash used in investing activities	(10.6)	(1,200.6)
Cash (used in) provided by financing activities	(807.1)	798.0
Effect of exchange rate changes on cash and cash equivalents	(33.2)	28.6
Decrease in cash and cash equivalents	(\$ 50.7)	(\$ 168.5)

Our cash flows from operating activities are largely a reflection of the size and composition of trading positions held by our market making subsidiaries, and of the changes in customer cash and margin debit balances in our electronic brokerage business. Our cash flows from investing activities are primarily related to the purchase of interests in IBG LLC from existing members, capitalized internal software development, purchases and sales of memberships at exchanges where we trade and, more recently, strategic investments in exchanges where such investments will enable us to offer better execution alternatives to our current and prospective customers, or create new opportunities for ourselves as market makers or where we can influence exchanges to provide competing products at better prices using sophisticated technology. Our cash flows from financing activities are comprised of proceeds from the issuance of common stock in connection with the IPO, short-term borrowings, long-term borrowings and capital transactions. Short-term borrowings from banks are part of our daily cash management in support of operating activities. Long-term borrowings provide us with flexible sources of excess liquidity and regulatory capital, and they include a committed senior secured revolving credit facility from a syndicate of banks that was initiated in May 2006, and senior notes issued in private placements to certain qualified customers of IB LLC.

**Nine months Ended September 30, 2008:** Our cash and cash equivalents decreased by \$50.7 million to \$471.0 million for the nine months ended September 30, 2008. We used net cash of \$817.7 million in our investing and financing activities primarily due to a decrease in our short term borrowings and payment of dividends to our members. We raised \$800.2 million in net cash from operating activities primarily from an increase in other payables, mostly to brokers, dealers and clearing organizations and an increase net income and minority interest.

**Nine months Ended September 30, 2007:** Our cash and cash equivalents decreased by \$168.5 million to \$669.3 million for the nine months ended September 30, 2007. We used net cash of \$1,200.6 million in our investing activities primarily due to the purchase of approximately 10% of IBG LLC historical members' interest and expenditures for property and equipment. We raised \$1,003.5 million in net cash from operating and financing activities primarily from the net proceeds from the issuance of our Class A and Class B Common Stock, an increase in net trading liabilities, reflecting the normal changes in our market making positions, and increased net income offset by decreases in securities loaned, net of securities borrowed and other receivables, net of other payables, mostly from broker, dealers and clearing organizations.

### **Capital Expenditures**

Our capital expenditures are comprised of compensation costs of our software engineering staff for development of software for internal use and expenditures for computer, networking and communications hardware. These expenditure items are reported as property and equipment. Capital expenditures for property and equipment were \$11.2 million and \$12.0 million for the nine month periods ended September 30, 2008 and 2007, respectively. We anticipate that our total 2008 gross capital expenditures will approximate \$20 million, primarily for expansion of our data center and backup facilities. We expect our future capital expenditures to rise as we continue our focus on technology infrastructure initiatives in order to further enhance our competitive position. We anticipate that we will fund capital expenditures with cash from operations and cash on hand. In response to changing economic conditions, we believe we have the flexibility to modify our capital expenditures by adjusting them (either upward or downward) to match our actual performance. If we pursue any strategic acquisitions, we may incur additional capital expenditures.

### **Seasonality**

Our business is subject to seasonal fluctuations, reflecting varying numbers of market participants at times during the year and varying numbers of trading days from quarter-to-quarter, including declines in trading activity due to holidays. Typical seasonal trends may be superseded by market or world events, which can have a significant impact on prices and trading volume.

### **Strategic Investments and Acquisitions**

We periodically engage in evaluations of potential strategic investments and acquisitions. The Company has made strategic investments in electronic trading exchanges, including Boston Options Exchange, LLC, OneChicago LLC, ISE Stock Exchange, LLC and CBOE Stock Exchange, LLC; made loans to W.R. Hambrecht + Co. Inc. with equity conversion rights; and acquired FutureTrade Technologies, LLC, a technology solutions provider to hedge funds and other institutional investors, and its wholly-owned subsidiary, FutureTrade Securities, LLC, which is an SEC registered broker-dealer. See the notes to the unaudited condensed consolidated financial statements in Item 1, Part 1 of this Quarterly Report on Form 10-Q for more information regarding our strategic investments.

We intend to continue making acquisitions on an opportunistic basis, generally only when the acquisition candidate will, in our opinion, enable us to acquire either technology or customers faster than we could develop them on our own. At September 30, 2008 there were no definitive agreements with respect to any material acquisition.

### **Certain Information Concerning Off-Balance-Sheet Arrangements**

Our subsidiaries derive revenues from buying and selling a variety of financial instruments. Certain of these instruments, including equity options and futures products, give rise to off-balance-sheet risk. Risk arises from changes in the value of these contracts (market risk) and also from the potential inability of counterparties to perform under the terms of the contracts (credit risk). Our market making subsidiaries rely upon proprietary computer systems that reevaluate our prices each second in order to minimize market risk inherent in their portfolios at any moment. Credit risk is limited in that substantially all of the contracts entered into are settled directly at securities and commodities clearing houses and a small portion is settled through member firms and banks with substantial financial and operational resources. Such clearing firms and banks are subject to the rules and regulations of the various contract markets in which they operate. Our subsidiaries' exposure is also limited in most locations by the segregation of assets, which protects our subsidiaries in the event of a bankruptcy or other disruption of business at the clearing firm or bank. Our subsidiaries also seek to control credit risk by following an established credit approval process prior to beginning business with a new counterparty.

For cash management purposes, certain of our subsidiaries enter into short-term securities purchased under agreements to resell transactions and securities sold under agreements to repurchase transactions (repos) in addition to securities borrowing and lending arrangements, all of which may result in credit exposure in the event the counterparty to a transaction is unable to fulfill its contractual obligations. In accordance with industry practice, repos are collateralized by securities with a market value in excess of the obligation under the contract. Similarly, securities borrowed and loaned agreements are collateralized by deposits and receipts of cash. Our subsidiaries attempt to minimize credit risk associated with these activities by monitoring collateral values on a daily basis and requiring additional collateral to be deposited with or returned to our subsidiaries when deemed necessary.

Securities sold but not yet purchased represent obligations of our subsidiaries to deliver the specified securities at the contracted price and, thereby, may create a liability to repurchase them in the market at prevailing prices. Accordingly, these transactions result in off-balance-sheet risk as our subsidiaries' repurchase of such securities may exceed the amount reported in our consolidated statement of financial condition. Our

continuous pricing and risk management systems are designed to minimize such risk on an overall portfolio basis.

## Critical Accounting Policies

### *Valuation of Financial Instruments*

IBG, Inc. adopted Statement of Financial Accounting Standards (“SFAS”) No. 157, “Fair Value Measurements” as of January 1, 2008. SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities and the lowest priority to unobservable inputs. The three levels of the fair value hierarchy under SFAS No. 157 are:

Level 1	Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;
Level 2	Quoted prices in markets that are not considered to be active or financial instruments for which all significant inputs are observable, either directly or indirectly; and
Level 3	Prices or valuations that require inputs that are both significant to fair value measurement and unobservable

In determining fair value, financial instruments owned and financial instruments sold, but not yet purchased, except forward currency contracts, which are classified as Level 2 financial instruments, are classified within Level 1 of the fair value hierarchy. Level 1 financial instruments, which are valued using quoted market prices as published by exchanges and clearing houses or otherwise broadly distributed in active markets, include U.S. government and sovereign obligations, active listed securities, options, futures, options on futures and corporate debt securities. IBG, Inc. does not adjust quoted prices for Level 1 financial instruments, even in the event that the Company may hold a large position whereby a purchase or sale could reasonably impact quoted prices. Currency forward contracts are classified as Level 2 financial instruments as such instruments are not exchange-traded.

IBG, Inc. also adopted SFAS No. 159, “The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115” as of January 1, 2008. SFAS No. 159 permits entities to choose, at specified election dates, to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. At adoption, the Company had no assets or liabilities for which it elected the fair value option. See Note 2 to the unaudited condensed consolidated financial statements in Part 1, Item 1 of this Quarterly Report on Form 10-Q for additional information regarding fair value.

### *Contingencies*

Our policy is to estimate and accrue for potential losses that may arise out of litigation and regulatory proceedings, to the extent that such losses are probable and can be estimated, in accordance with Statement of Financial Accounting Standards SFAS No. 5, “Accounting for Contingencies.” Potential losses that might arise out of tax audits, to the extent that such losses are “more likely than not”, would be estimated and accrued in accordance with FIN No. 48. Significant judgment is required in making these estimates and our final liabilities may ultimately be materially different. Our total liability accrued with respect to litigation and regulatory proceedings is determined on a case-by-case basis and represents an estimate of probable losses based on, among other factors, the progress of each case, our experience with and industry experience with similar cases and the opinions and views of internal and external legal counsel. Given the inherent difficulty of predicting the outcome of our litigation and regulatory matters, particularly in cases or proceedings in which substantial or indeterminate damages or fines are sought, or where cases or proceedings are in the early stages, we cannot estimate losses or ranges of losses for cases or proceedings where there is only a reasonable possibility that a loss may be incurred.

IBG LLC has been, and we likely will be, from time to time subject to litigation and other legal proceedings. As of September 30, 2008, certain subsidiaries of IBG LLC have been named parties to legal actions, which IBG LLC or such subsidiaries intend to defend vigorously. Although the results of legal actions cannot be predicted with certainty, it is the opinion of management that the resolution of these actions is not expected to have a material adverse effect, if any, on IBG LLC’s business or financial condition, but may have a material impact on the results of operations for a given period. As of September 30, 2008 and 2007, respectively, reserves provided for potential losses related to litigation matters were not material.

*Use of Estimates*

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts and disclosures in the unaudited condensed consolidated financial statements

and accompanying notes. Estimates, by their nature, are based on judgment and available information. Therefore, actual results could differ materially from those estimates. Such estimates include the estimated fair value of financial instruments and investments accounted for under the equity method of accounting, the estimated useful lives of property and equipment, including capitalized internally developed software, compensation accruals, tax liabilities and estimated contingency reserves.

### **Recent Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141(R), "Business Combinations." SFAS No. 141(R) replaces SFAS No. 141, mandating changes in the accounting for business combinations most notably that changes in purchase price allocations, if made, are required to be applied retrospectively, whereas under SFAS No. 141, such changes were applied prospectively. SFAS No. 141(R) is effective for an entity's fiscal year beginning after December 15, 2008, and early adoption is not permitted. The Company cannot anticipate whether adoption of SFAS No. 141(R) will have a material effect on its unaudited condensed consolidated financial statements as such effect would be solely dependent on whether the Company enters into business combinations after December 31, 2008 and the terms of such transactions.

In December 2007, the FASB issued SFAS No. 160, "Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51." SFAS No. 160 requires non-controlling ("minority") interests in a reporting entity to be reported as a component of the entity's stockholder's equity. SFAS No. 160 is effective for an entity's fiscal year beginning after December 15, 2008, and early adoption is not permitted. Management is assessing the potential impact on the Company's unaudited condensed consolidated financial statements of adopting SFAS No. 160.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133." SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities, and is effective for financial statements issued for fiscal years beginning after November 2008. SFAS No. 161 will not affect the Company's financial condition, results of operations or cash flows. Adoption of SFAS No. 161 is not expected to have a material effect on our unaudited condensed consolidated financial statements.

On May 9, 2008, the FASB issued SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities in accordance with U.S. GAAP. This Statement will be effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to AU Section 411, "The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles." Adoption of SFAS No. 162 is not expected to have a material effect on our unaudited condensed consolidated financial statements.

### **Forward-Looking Statements**

We have included in Parts I and II of this Quarterly Report on Form 10-Q, and from time to time our management may make, statements which may constitute "forward-looking statements" within the meaning of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Statements that are not historical facts, including statements about our beliefs and expectations, are forward looking statements. Forward looking statements include statements preceded by, followed by or that include the words "may," "could," "would," "should," "believe," "expect," "anticipate," "plan," "estimate," "target," "project," "intend" and similar expressions. These statements include, among others, statements regarding our expected business outlook, anticipated financial and operating results, our business strategy and means to implement the strategy, our objectives, the amount and timing of capital expenditures, the likelihood of our success in expanding our business, financing plans, budgets, working capital needs and sources of liquidity.

Forward looking statements are only predictions and are not guarantees of performance. These statements are based on our management's beliefs and assumptions, which in turn are based on currently available information. Important assumptions relating to the forward looking statements include, among others, assumptions regarding demand for our products, the expansion of product offerings geographically or through new applications, the timing and cost of planned capital expenditures, competitive conditions and general economic conditions. These assumptions could prove inaccurate. Forward looking statements also involve known and unknown risks and uncertainties, which could cause actual results

## Edgar Filing: Interactive Brokers Group, Inc. - Form 10-Q

that differ materially from those contained in any forward looking statement. Many of these factors are beyond our ability to control or predict. Important factors that could cause actual results to differ from those in our specific forward-looking statements include, but are not limited to, those discussed under “Risk Factors” beginning on page 17 of our Annual Report on Form 10-K. Except as required by applicable law, including the securities laws of the United States and the rules and regulations of the SEC, we are under no obligation to publicly update or revise any forward looking statements after the date of this Quarterly Report on Form 10-Q.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to various market risks. Our exposures to market risks arise from assumptions built into our pricing models, equity price risk, foreign currency exchange rate fluctuations related to our international operations, changes in interest rates which impact our variable-rate debt obligations, and risks relating to the extension of margin credit to our customers.

#### *Pricing Model Exposure*

Our strategy as a market maker is to calculate quotes a few seconds ahead of the market and execute small trades at tiny but favorable differentials as a result. This is made possible by our proprietary pricing model, which continuously evaluates and monitors the risks inherent in our portfolio, assimilates market data and reevaluates the outstanding quotes in our entire portfolio each second. Certain aspects of the model rely on historical prices of securities. If the behavior of price movements of individual securities diverges substantially from what their historical behavior would predict, we might incur trading losses. We attempt to limit such risks by diversifying our portfolio across many different options, futures and underlying securities and avoiding concentrations of positions based on the same underlying security. Historically, our losses from these events have been immaterial in comparison to our annual trading profits.

#### *Foreign Currency Exposure*

As a result of our international market making activities and accumulated earnings in our foreign subsidiaries, our income and net worth is exposed to fluctuations in foreign exchange rates. Our European operations and some of our Asian operations are conducted by our Swiss subsidiary, THE. THE is regulated by the Swiss Federal Banking Commission as a securities dealer and its financial statements are presented in Swiss francs. Accordingly, THE is exposed to certain foreign exchange risks as described below:

- THE buys and sells futures contracts and securities denominated in various currencies and carries bank balances and borrows and lends such currencies in its regular course of business. At the end of each accounting period THE's assets and liabilities are translated into Swiss francs for presentation in its financial statements. The resulting gains or losses are reported as translation gain or loss in THE's income statement. When we prepare our consolidated financial statements, THE's Swiss franc balances are translated into U.S. dollars for U.S. GAAP purposes. THE's translation gains or losses appear as such on IBG, Inc.'s income statement, included in trading gains.
- THE's net worth is carried on THE's books in Swiss francs in accordance with Swiss accounting standards. At the end of each accounting period, THE's net worth is translated at the then prevailing exchange rate into U.S. dollars and the resulting gain or loss is reported in our consolidated statement of financial condition as "other comprehensive income," which is neither an income nor an expense item in our statement of income, in accordance with U.S. GAAP.

Historically, we have taken the approach of not hedging the above exposures, based on the notion that the cost of constantly hedging over the years would amount to more than the random impact of rate changes on our non-U.S. dollar balances. For instance, an increase in the value of the Swiss franc would be unfavorable to the earnings of THE but would be counterbalanced to some extent by the fact that the yearly translation gain or loss into U.S. dollars is likely to move in the opposite direction.

In late 2005, we began to expand our market making systems to incorporate cash forex and forex options in order to hedge our currency exposure at little or no cost. In September 2006, we began hedging our currency exposure throughout the day on a continuous basis. In connection with the development of our currency hedging strategy, we have determined to base our net worth in GLOBALs. We define the GLOBAL as consisting of a basket of major currencies that currently includes U.S. dollar, Euro, Japanese yen, British pound, Canadian dollar and Australian dollar. With the growth of our international operations, we foresee including other currencies in our definition of the GLOBAL. As our forex market making systems continue to develop, and as more exchanges trade more forex-based products electronically, we expect more trading volume to flow through this system and, accordingly, we expect to be able to manage the risks in forex in the same low cost manner as we currently manage the risks of our market making in equity-based products.



***Interest Rate Risk***

We had \$300.0 million in variable-rate debt outstanding at September 30, 2008. These debt obligations are subject to fluctuations in interest rates at the end of each borrowing term, which impact the amount of interest we must pay. If variable interest rates were to increase by 0.5% per annum, the annual impact to our net interest income would be a reduction of \$1.5 million. Under our senior secured revolving credit facility, we have the ability to choose borrowing tenors from overnight to twelve months, which permits us to minimize the risk of interest rate fluctuations.

We pay our electronic brokerage customers interest based on benchmark overnight interest rates in various currencies. We do not pay interest on the first \$10,000 in cash balances. A decrease of 0.5% per annum in benchmark interest rates would reduce our net interest income by approximately \$3.8 million on an annualized basis.

We also face substantial interest rate risk due to positions carried in our market making business to the extent that long or short stock positions may have been established for future or forward dates on options or futures contracts and the value of such positions are impacted by interest rates. We hedge such risks by entering into interest rate futures contracts. To the extent that these futures positions do not perfectly hedge this interest rate risk, our trading gains may be adversely affected. The amount of such risk cannot be quantified.

***Dividend Risk***

We face dividend risk in our market making business as we derive significant revenues and incur significant expenses in the form of dividend income and expense, respectively, from our substantial inventory of equity securities, and must make significant payments in lieu of dividends on short positions in securities in our portfolio. Projected future dividends are an important component of pricing equity options and other derivatives, and incorrect projections may lead to trading losses. The amount of these risks cannot be quantified.

***Margin Credit***

We extend margin credit to our customers, which is subject to various regulatory requirements. Margin credit is collateralized by cash and securities in the customers' accounts. The risks associated with margin credit increase during periods of fast market movements or in cases where collateral is concentrated and market movements occur. During such times, customers who utilize margin credit and who have collateralized their obligations with securities may find that the securities have a rapidly depreciating value and may not be sufficient to cover their obligations in the event of a liquidation. We are also exposed to credit risk when our customers execute transactions, such as short sales of options and equities, that can expose them to risk beyond their invested capital.

We expect this kind of exposure to increase with growth in our overall business. Because we indemnify and hold harmless our clearing firms from certain liabilities or claims, the use of margin credit and short sales may expose us to significant off-balance-sheet risk in the event that collateral requirements are not sufficient to fully cover losses that customers may incur and those customers fail to satisfy their obligations. As of September 30, 2008, we had \$1.83 billion in margin credit extended to our customers. The amount of risk to which we are exposed from the margin credit we extend to our customers and from short sale transactions by our customers is unlimited and not quantifiable as the risk is dependent upon analysis of a potential significant and undeterminable rise or fall in stock prices. Our account level margin credit requirements meet or exceed those required by Regulation T of the Board of Governors of the Federal Reserve. As a matter of practice, we enforce real-time margin compliance monitoring and liquidate customers' positions if their equity falls below required margin requirements.

We have a comprehensive policy implemented in accordance with regulatory standards to assess and monitor the suitability of investors to engage in various trading activities. To mitigate our risk, we also continuously monitor customer accounts to detect excessive concentration, large orders or positions, patterns of day trading and other activities that indicate increased risk to us.

Our credit exposure is to a great extent mitigated by our policy of automatically evaluating each account throughout the trading day and closing out positions automatically for accounts that are found to be under-margined. While this methodology is effective in most situations, it may not be effective in situations where no liquid market exists for the relevant securities or commodities or where, for any reason, automatic liquidation for certain accounts has been disabled.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures.**

Our management, including our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures pursuant to Rule 13a-15 under the Exchange Act as of the end of the period covered by this report. Based on that evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) are effective, in all material respects, to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In addition, no change in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) occurred during our most recent fiscal quarter that has materially affected, or is likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

There have been no material changes to the legal proceedings disclosed under Part 1, Item 3 of our Annual Report on Form 10-K filed with the SEC on March 27, 2008. During our normal course of business, the Company's regulated operating companies are in discussions with regulators about matters raised during regulatory examinations or otherwise subject to their inquiry. These matters could result in censures, fines or other sanctions. Management believes the outcome of any resulting actions will not be material to the Company's financial condition, results of operations or cash flows. However, the Company is unable to predict the outcome of these matters.

The Company believes, based on current knowledge and after consultation with counsel, that the outcome of the pending matters will not have a material adverse effect on the consolidated financial condition of the Company. Legal reserves have been established in accordance with SFAS No.5 "Accounting for Contingencies." The ultimate resolution may differ from the amounts reserved.

### **ITEM 1A. RISK FACTORS**

There have been no material changes to the risk factors disclosed in under Part 1, Item 1A of our Annual Report on Form 10-K filed with the SEC on March 27, 2008.

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

### **ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

The annual meeting of stockholders of Interactive Brokers Group, Inc. (the "Company") was held on July 8, 2008.

The stocker holders voted on proposals to elect directors to the Company's Board of Directors (the "Board") and to ratify the appointment of Deloitte & Touche LLP as independent auditor. The stockholders also voted on a Company proposal to approve the 2007 Stock Incentive Plan.

All nominees for election to the board were elected for a one year term expiring at the Annual Meeting of Stockholder in the following year. Each director will hold office until his successor has been elected and qualified or until the director's earlier resignation or removal. The stockholders' vote ratified the appointment of the independent auditor and approved the 2007 Stock Incentive Plan.

The number of votes cast for or against and the number of abstentions with respect to each proposal is set forth below. The Company's independent inspector of election reported the vote of the stockholders as follows:

	<b>For</b>	<b>Against</b>	<b>Abstain</b>	<b>Broker Non-Vote</b>
<b>Election of Directors (percentages shown are of the votes cast)</b>				
Thomas Peterffy	376,111,740 96.17%	14,942,443 3.82%	19,701 0.01%	-
Earl H. Nemser	375,972,149 96.14%	15,081,994 3.86%	19,741 0.01%	-
Paul J. Brody	381,421,562 97.53%	9,632,584 2.46%	19,738 0.01%	-
Milan Galik	381,421,959 97.53%	9,632,184 2.46%	19,741 0.01%	-
Lawerence E. Harris	390,459,133 99.84%	595,010 0.15%	19,741 0.01%	-
Hans R. Stoll	390,457,594 99.84%	596,549 0.15%	19,741 0.01%	-
Ivers W. Riley	390,472,674 99.85%	597,049 0.15%	4,161 0.00%	-
<b>Appointment of Deloitte &amp; Touche LLP</b>	390,927,361	141,474	5,049	-
<b>Approval of the 2007 Stock Incentive Plan</b>	363,914,012	23,489,474	308,625	3,361,773

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

31.1 Certification of Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INTERACTIVE BROKERS GROUP, INC.

/s/ Paul J. Brody

Name: Paul J. Brody

Title: Chief Financial Officer, Treasurer and Secretary

(Signing both in his capacity as a duly authorized officer and  
as principal financial officer of the registrant)

Date: November 10, 2008