

IG GROUP HOLDINGS PLC

IGG.L Sector: Online Investment Trading

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Update

After the first equity report the fund purchased 52 shares in IG Group at the market price of 582.00 (GBX), totalling £302.51 excluding transaction fees. Since then however, the market price has fallen and the stake in the company has subsequently been sold. The 52 shares in the company were sold for 519.50 each on the 21st March. The fall in market price was due to tighter regulations hitting the company, denting their third-quarter revenues. The new strict regulations means there are tighter rules on who can make highly-leveraged speculations on certain products in the market place. The consequence of this is a shrinking customer base for IG Group, ultimately resulting in uncertainty and a deflated share price in which they will likely not recover from – at least not in the short-term. Our decision to sell was backed up by a lower P/E ratio since the first report as well as a lower value of market capitalisation for the company. These are indicators of a declining performance for the firm.

Business Model

IG Group Holdings plc is a United Kingdom-based company which is engaged in online trading. The Company provides contracts for difference (CFDs) in over 17 countries globally. The Company's segments include UK, Australia, Europe and Rest of World. The UK segment consists of its operations in the United Kingdom and Ireland, and derives its revenue from financial spread bets, CFDs, binary options and execution only stockbroking. The Australian segment derives its revenue from CFDs and binary options. The Europe segment consists of its operations in France, Germany, Italy, Luxembourg, the Netherlands, Norway, Spain, Sweden and Switzerland, and derives its revenue from CFDs, binary options and execution only stockbroking. The Rest of World segment consists of its operations in Japan, South Africa, Singapore, the United States, the United Arab Emirates and Dubai, and derives revenue from the operation of a regulated futures and options exchange, as well as CFDs and binary options.

Investment Rationale

IG have fallen 37% over the last 6 months, this is largely due to new regulatory restrictions that are hitting revenue. This is not unique to IGG and rival companies such as Plus 500 and CMC Markets have issued profit warnings relating to this.

However, for long-term investors we can buy the market leader on a discounted price of around 27%. (Appendix 1) IG have been in the business for 45 years and they're global leaders within the CFD trading and spread betting sector. They're a very profitable and well funded business. IG have consistently maintained a positive net cash position. This allows them to adapt to change and IG are looking into diversification. Next month a large report is due on their fundamental

OUTCOME

SOLD

Current Price

513.00

Our Valuation Range

519.00-800.00

IG have generated a 47% pre-tax profit over the last 5 years. IG present LSMIF a good opportunity to buy as IG can be currently bought with a 27% discount rate. The graph below demonstrates.



Revenue	Previous 595m	Update 595m
Net Income	226m	226m
Incorporated in	2003	2003
Employees	16,000	16,000
52-week range	524.5- 956.5	519- 800
Average volume	1.44m	1.85m
Shares outstanding	1.36m	368.8m
Free float	365.06m	365.04 m
P/E (TTM)	10.24	9.08
Market cap	2.13bn	1.89bn
EPS (TTM)	£0.5647	£0.564 7
Cash flow per share	0.612	0.612
Price/Cash flow per share	9.38	8.32
Book value per share	2.22	2.22
Tangible book value per share	1.80	1.80
Net profit margin	36.56%	36.56%
Operating margin	44.83%	44.83%
Annual div (ADY)	25.92	0.43
Annual div yield (ADY)	4.48%	0.05%
Return on assets	20.06%	20.06%
Return on equity	26.74%	26.74%
Return on investment	25.14%	25.14%

operational changes. This presents a fantastic opportunity in which to buy IG stocks before the prices balance.

Year on year IG grew revenues 13.78% from 523.30m to 595.40m while net income improved 33.81% from 169.20m to 226.40m. (Appendix 2)

IG appear to have a strong balance sheet and has grown its cash reserves consistently over the last four years to total 289.70m. (Appendix 3)

In 2018, IG increased its cash reserves by 25.47%, or 58.80m. The company earned 227.70m from its operations for a Cash Flow Margin of 38.24%. In addition the company used 40.30m on investing activities and also paid 127.10m in financing cash flows.

Investment Risks

With all investments comes risk, but IG presents a very low volatile stock option with a current beta of 0.32.

However they have fallen by 37% and this could indicate a future decline. Competitors and rivals themselves are falling victim to the new regulations. This is combated by IG's 45 year history and contemporary balance/profit and loss accounts.

Furthermore IG earnings are positive but are not above the UK market average, the same can be said about their revenue growth. This is something to keep track of because if it becomes a trend this may lead to stock volatility.

Finally, Brexit is a risk to the market as a whole. The uncertainty has led to investors and speculators to remain cautious. This could further explain the recent decline in IG stocks price as the combination of new regulations plus Brexit woes could lead to doubts. However, this also presents opportunity of which we should capitalise upon.

Supplementary Data

Appendix 1 - Discounted Cash Flow

LSE:IGG Discounted Cash Flow Data Sources

Data Point	Source	Value
Valuation Model		Excess Returns Model
Stable EPS	Median Return on Equity from the past 5 years. = Stable Book Value * Return on Equity = £2.01 * 23.2%	£0.47
Book Value of Equity per Share	Median Book Value from the past 5 years.	£2.01
Discount Rate (Cost of Equity)	See below	6.8%
Perpetual Growth Rate	10-Year GB Government Bond Rate	1.2%

An important part of a discounted cash flow is the discount rate, below we explain how it has been calculated.

Calculation of Discount Rate/ Cost of Equity for LSE:IGG

Data Point	Calculation/ Source	Result
Risk-Free Rate	10-Year GB Govt Bond Rate	1.2%
Equity Risk Premium	S&P Global	6.7%
Capital Markets Unlevered Beta	Simply Wall St/ S&P Global	0.73
Re-levered Beta	= Unlevered beta (1 + (1- tax rate) (Debt/Equity)) = 0.734 (1 + (1- 19%) (4.69%))	0.84
Levered Beta	Levered Beta limited to 0.8 to 2.0 (practical range for a stable firm)	0.84
Discount Rate/ Cost of Equity	= Cost of Equity = Risk Free Rate + (Levered Beta * Equity Risk Premium) = 1.23% + (0.84 * 6.65%)	6.82%

Discounted Cash Flow Calculation for LSE:IGG using Excess Returns Model Model

The calculations below outline how an intrinsic value for IG Group Holdings is arrived at using the Excess Return Model. This approach is used for finance firms where free cash flow is difficult to estimate.

In the Excess Return Model the value of a firm can be written as the sum of capital invested currently in the firm and the present value of excess returns that the firm expects to make in the future.

The model is sensitive to the Return on Equity of the company versus the Cost of Equity, how these are calculated is detailed below the main calculation.

Note the calculations below are per share.

See our [documentation](#) to learn about this calculation.

LSE:IGG Value of Excess Returns

	Calculation	Result
Excess Returns	= (Stable Return on equity - Cost of equity) (Book Value of Equity per share) = (23.2% - 6.82%) * £2.01	£0.33
Terminal Value of Excess Returns	= Excess Returns / (Cost of Equity - Expected Growth Rate) = £0.33 / (6.82% - 1.23%)	£5.90
Value of Equity	= Book Value per share + Terminal Value of Excess Returns = £2.01 + £5.90	£7.9

LSE:IGG Discount to Share Price

	Calculation	Result
Value per share (GBP)	From above.	£7.90
Current discount	Discount to share price of £5.78 = -1 x (£5.78 - £7.90) / £7.90	26.9%

Appendix 2 Income Statement (Profit & Loss)

Fiscal data as of May 31 2018	2018	2017	2016	2015	2014
REVENUE AND GROSS PROFIT					
Total revenue	595	523	492	427	414
OPERATING EXPENSES					
Cost of revenue total	27	36	43	40	42
Selling, general and admin. expenses, total	--	--	--	--	--
Depreciation/amortization	--	--	--	--	--
Unusual expense(income)	--	--	--	--	--
Other operating expenses, total	287	274	241	217	177
Total operating expense	314	310	284	257	218
Operating income	281	213	208	170	195
Other, net	(1.8)	(0.3)	0	(0.4)	--
INCOME TAXES, MINORITY INTEREST AND EXTRA ITEMS					
Net income before taxes	281	214	208	170	195
Provision for income taxes	54	45	44	38	48
Net income after taxes	226	169	164	132	147
Minority interest	--	--	--	--	--
Net income before extra. Items	226	169	164	132	147
Total extraordinary items	--	--	--	--	--
Net income	226	169	164	132	147
Inc.avail. to common excl. extra. Items	226	169	164	132	147
Inc.avail. to common incl. extra. Items	226	169	164	132	147
EPS RECONCILIATION					
Basic/primary weighted average shares	367	366	366	365	365
Basic/primary eps excl. extra items	0.62	0.46	0.45	0.36	0.40
Basic/primary eps incl. extra items	0.62	0.46	0.45	0.36	0.40
Dilution adjustment	0	--	0	0	0
Diluted weighted average shares	370	369	369	367	366
Diluted eps excl. extra items	0.61	0.46	0.45	0.36	0.40
Diluted eps incl. extra items	0.61	0.46	0.45	0.36	0.40
COMMON STOCK DIVIDENDS					
DPS - common stock primary issue	0.43	0.32	0.31	0.28	0.28
Gross dividend - common stock	159	119	115	103	103
PRO FORMA INCOME					
Pro forma net income	--	--	--	--	--
Interest expense, supplemental	1.40	1.10	1.70	1.50	--
SUPPLEMENTAL INCOME					
Depreciation, supplemental	6.90	7.90	5.20	5.70	4.66
Total special items	--	--	--	--	--
NORMALISED INCOME					
Normalized income before taxes	281	214	208	170	195

(Financial Times, 2019)

Appendix 3 Balance Sheet (Statement of Financial Position)

Fiscal data as of May 31 2018	2018	2017	2016	2015	2014
ASSETS					
Cash And Short Term Investments	352	323	330	182	152
Total Receivables, Net	383	346	279	270	328
Total Inventory	--	--	--	--	--
Prepaid expenses	12	12	12	12	12
Other current assets, total	27	12	--	--	--
Total current assets	774	693	621	464	492
Property, plant & equipment, net	16	17	13	13	13
Goodwill, net	108	108	107	107	--
Intangibles, net	43	49	18	17	123
Long term investments	112	52	25	76	32
Note receivable - long term	--	--	--	--	--
Other long term assets	--	--	--	--	--
Total assets	1,061	928	791	683	667
LIABILITIES					
Accounts payable	127	117	43	18	22
Accrued expenses	--	--	--	61	--
Notes payable/short-term debt	0	0	0	0	0
Current portion long-term debt/capital leases	--	--	--	--	0
Other current liabilities, total	92	76	85	13	79
Total current liabilities	219	193	128	92	101
Total long term debt	0	0	0	0	0
Total debt	0	0	0	0	0
Deferred income tax	--	--	--	--	--
Minority interest	--	--	--	--	--
Other liabilities, total	--	--	--	--	--
Total liabilities	219	193	128	92	101
SHAREHOLDERS EQUITY					
Common stock	--	--	0	0	--
Additional paid-in capital	207	207	207	207	207
Retained earnings (accumulated deficit)	579	465	406	338	274
Treasury stock - common	(7.4)	(3.3)	(1.8)	(1.2)	--
Unrealized gain (loss)	(0.1)	0.10	0.30	0.40	--
Other equity, total	63	66	52	47	85
Total equity	842	735	663	591	566
Total liabilities & shareholders' equity	1,061	928	791	683	667
Total common shares outstanding	368	367	367	366	366
Treasury shares - common primary issue	0	0	0	0	0

(Financial Times, 2019)

LINCOLN STUDENT MANAGED INVESTMENT FUND (LSMIF)

Founded in 2018, the Lincoln Student Managed Investment Fund (LSMIF) is exactly what it says on the tin, a fund which will analyse, determine upon, and purchase shares to create a portfolio. The only difference is we are students. No simulations, just our knowledge and ability vs the real market. The best test of our teachings and learnings.

The fund is set up with a structure similar to any other professionally run fund Management Company with students running every aspect of the fund, from CEO to analyst. It is designed to give any student involved the best experience of the financial world possible before getting a job.

The fund will be handed down to new students each year as those partake in this fund finish their studying. The fund aims to grow in the future, with more positions available to give the most number of students the chance to partake.

The ultimate goal of the fund is to raise the profile of each student involved to allow for them to get the best experience possible. We, however, set the following objectives to make the fund grow on sustainable basis:

- To generate long-term returns from investments using our stylized investment strategies.
- To raise funds through crowdfunding and donors to help increase the capital base.
- To increase the number of students involved in the fund with expanded capital base.
- To link the fund's activities with the related programmes and modules' assessments
- To get more outside sponsors who want to work directly with the fund as well, to further simulate the professional environment.

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