Plus500

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Executive summary:

- Israeli-based international trading platform for the financial instrument known as a Contract of Difference (CFD) and also a disruptor of the CFD trading industry
- Company trades on the AIM Stock Exchange in London
- Company trades at <6 estimated 2017 FCF multiple (deducting cash on the balance sheet for the calculation)
- Strong sales growth: 20% annually both of the last two years
- Strong conversion of earnings to FCF
- Low capital requirements
- Large insider ownership
- Recently announced buyback plan is in motion
- Leading player of “unpopular” industry that we believe is maturing and will become standardized and regulated in a way preventing entrance of new competitors
- Primary market concern is new regulatory environment (we believe Plus500 has the ability to adjust while maintaining good margins and growth)
- We believe this to be a *high uncertainty* rather than *high risk* investment.

Company overview

Plus500 provides an advanced trading platform for retail customers using the trading financial instrument “Contract of Difference”, or CFD. From Wikipedia: “a contract of difference (CFD) is a contract between two parties, typically described as "buyer" and "seller", stipulating that the seller will pay to the buyer the difference between the current value of an asset and its value at contract time (if the difference is negative, then the buyer pays instead to the seller). In effect CFDs are financial derivatives that allow traders to take advantage of prices moving up (long positions) or prices moving down

Eyal Weitzner
eyal@anafacapital.com
+972-54-540-9039

(short positions) on underlying financial instruments and are often used to speculation those markets".

While illegal in the U.S., CFD trading is popular in the U.K, the E.U and other parts of Europe, Asia and the Middle East, among other parts of the world, as it holds some advantages compared to holding stocks, such as the ability to use leverage on a trade and a favorable tax treatment.

One might argue that CFDs have more to do with gambling than financial and investment tools, but it is important to note that most institutional brokers around the world offer CFDs to their clients.

At present, there are over 2,100 different global financial instruments that have CFD representation on the company platform. These assets include equities, indices, commodities, options, exchange-traded funds (ETFs) and foreign exchange.
Plus500's platform operates in more than 50 countries, in 31 languages, and is available on desktops, smartphones and tablets.
In fiscal year 2016, the platform was used by 104,432 customers and generated $328M of revenue compared to 84,858 customers in 2015 and $276M of revenue.

The company retains operating licenses and is regulated in the United Kingdom, Australia, Cyprus, South Africa, New Zealand and Israel.
In 2016, approximately 19% of revenue was generated in the UK and 61% in Europe.
Plus500 is the second largest CFD provider in the U.K.

Currently, early August 2017, Plus500's market cap is £900M ($1.17B) - the company's stock is quoted in GBP but reports in USD. As an AIM listed company, Plus500 reports semi-annually.

2016 earnings were $117M, and on the balance sheet, the company had $136.5M.

The H1 2017 report showed revenue of $188.4M compared to $158.8M in H1 2016 and earnings of $90M compared to $44.5 in H1 2016.

Eyal Weitzner
eyal@anafacapital.com
+972-54-540-9039

It also reflects the creation of $84M of FCF. We estimate this to be on an annual run rate to reach $150-160M of FCF.

The company has adopted a 60% payout ratio policy allocated between cash, dividends and buy backs.

The following table summarizes Plus500's basic multiplier information:

Strong insider ownership

From the six original founders, five are still working in the company in different roles, most notably Gal Haber, who was CEO until March 2016 and is currently Managing Director. Interestingly, all five founders receive the same salary.
Three founders are also stock holders, altogether owning 17.65% of the company, which in our mind, is a signal of alignment between management and outside passive investors.

A tech company with a financial product - not a financial company

One of the key differences between Plus500 and its competitors is that its founders were engineers and software developers rather than people with financial backgrounds. This led to a strategic decision to build the trading platform internally instead of buying a license for an existing third-party platform. Developing and owning the trading platform creates several advantages for Plus500:

- The ability to provide new customers demo accounts without limiting the time of use
- The ability to open client accounts with lower minimum amount thresholds to open real-money trades
- The ability to provide real-time price and data analysis features to customers on the trading platform, free of charge

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+972-54-540-9039

Technological competency has also enabled the platform to be exceptionally user-friendly. We believe that Plus500's technological core strength creates a strong advantage compared to peers.

Additionally, the company has developed its own proprietary marketing software, "the marketing machine". It allows Plus500 to optimize all resources and efforts devoted to creating new leads and acquiring new customers. The marketing machine is said to have features such as the ability to track and manage more than a million relevant Google Ad words.

Recent operational results and current issues

The following table charts selected financial parameters since Plus500's IPO:

	Key Financial data (000$)				
Parameter	**2016**	**2015**	**2014**	**2013**	**2012**
TRADING INCOME	327,927	275,651	228,865	115,088	56,127
Y/Y Growth	19%	20%	99%	105%	
INCOME FROM OPERATIONS	150,518	132,482	145,322	67,203	23,073
IFO Margin	46%	48%	63%	58%	41%
PROFIT AND COMPREHENSIVE INCOME	117,242	96,567	102,452	50,633	17,100
Profit margin	36%	35%	45%	44%	30%
EARNINGS PER SHARE (basic and diluted)	$ 1.02	$ 0.84	$ 0.89	$ 0.47	$ 0.17
Cash and cash equivalents	136,481	156,497	139,164	84,108	22,486
Total equity	136,000	117,654	110,460	68,014	11,947
Y/Y Growth	16%	7%	62%	469%	
FCF	103,326	84,049	117,240	57,759	19,536
FCF margin	32%	30%	51%	50%	35%
ROE	86%	82%	93%	74%	143%

As demonstrated in the table, Plus500 produces 80%+ ROE (without leverage) and can convert about a third of its income to earnings and FCF. We also note that the

incremental cost of a new platform user is minimal, and the business does not require massive capital investments.
So why is a company that doesn't need capital to grow and is growing at a rate of 20% a year while displaying 30% FCF margin on sales trades only a single digit earning multiplier?

Regulatory maturing of an industry and regulatory fears

We believe that regulatory uncertainty is the key reason for Plus's low valuation. As the on-line trading industry grows, it is slowly attracting the eyes of various regulators. For example, the trading of binary options, a notorious financial-like but more gambling-related product, will likely be outlawed by most OECD financial regulators. It is important to note that Plus500 does not provide binary options for its customers, and fortunately, Plus500 has always adapted its practices to developing regulatory standards.

European regulators would like to stop several other trading industry practices deemed hazardous, the most concerning including:

- New customer welcome bonuses: giving money to customers to trade on their new accounts on the platforms.
- Setting default levels of leverage: standardizing the amounts of leverage customers may access, amounts that differ between new traders and experienced traders
- Negative balance protection mechanisms: allowing clients to lose more money than what is deposited in their accounts (Plus500 does not engage in this practice).

On December 1, 2016, CYsec, the Cypriot financial regulator, formally issued a statement questioning some of these practices. Plus500 issued its own statement in reply that it did not see any effect from the Cypriot regulator; however, the company's stock price collapsed 40% within a month (rebounding only recently).

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The next place to watch will be Europe. The FCA, the UK's regulator, issued a statement on June 29th, 2017 declaring that its new regulatory guidelines will be issued following new EU regulatory guidelines expected in 2018 by ESMA, the EU's regulator.

Altogether, reading different recent regulatory statements, we believe that the likely scenario of industry regulation will be a tightening of standards and demands from trading platforms although not a complete ban on the trading industry. With higher capital requirements likely needed to comply with legal and technological regulation, new companies will face higher barriers to enter the industry and smaller competitors may be forced to consolidate or leave the industry altogether - all benefitting Plus500. Thus, assuming rational behavior from the industry players, we can expect a satisfactory return from Plus500. However, it is likely, too, that the future will be less profitable than the past with stronger regulation.

Comps

The following table provides details about and relevant comparison between British public competitors in the industry:

	MKT CAP	P/E (2016)	P/B (2016)	P/S (2016)	12-16 Rev Growth CAGR	12-16 Rev EPS CAGR	ROE (2016)	16 Net Profit margin
IGG	£ 2,343	14.3	3.5	4.8	3.6%	3.40%	25%	42%
Plus 500	£ 678	7.8	6.2	2.8	47.0%	47.80%	79%	35%
CMC MARKETS	£ 432	11.1	2.2	2.3	46.9%	N/A	20%	39%

Plus500 is trading at the lowest P/E multiple while producing the highest ROE. One possible explanation is Plus500's exclusively CFD-oriented platform (other competitors offer additional financial products, such as Forex trading, spread betting and binary options). Another explanation is Plus500's retail client focus, as competitors with institutional customers are likely to be less affected by upcoming regulatory changes.

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H1 2017 strong results

On August 7th, Plus500 posted a very strong mid-year report, with highlights including:

- Revenue of $188.4M (19% growth compared to H1 2016)
- 112,317 active customers (8% growth compared to H1 2016)
- Net profit of $90.7M (104% growth compared to H1 2016) - driven by a decline in customer acquisition cost
- FCF of $84M (147% Growth H1 2016)

If we assume annualized results, we should see FCF reaching $150M-160M and earnings reaching $180M-200M - and that's for a company with a market cap of $1.17B and $220M on the balance sheet.

Valuation

- Bear case: We estimate an almost complete decline in growth following new 2018 regulation and a strong decline in FCF margins to 24% of sales. In this scenario, intrinsic value is £8.24 per share or close to the current market prices.

- Base case: We estimate a strong decline in revenue growth following 2018 to around 10% annually (approximately half of recent historical actual growth rate). In this scenario, we also estimate a 10% decline in FCF margin to ~27% and an intrinsic value at £11.59 per share, a price representing a 41% margin of safety to current price of 8.17£.

- Bull case: We estimate no change in historical growth and FCF margins following 2018 new regulation, and the company continues to grow at a 20% annual rate for a few years and then matures to a slower growth rate. FCF margins remain at 30% of sales. In this scenario, intrinsic value is £18.01 per share, 120% higher than current prices.

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2015 distressed sale as a signal of intrinsic value

In July 2015, Plus500 went through a regulatory crisis, although it passed without material damage and is rumored to have been instigated by fearful competitors.
At that time, Plus500 received a buyout offer by a gambling company, Playtech, for £4 per share, representing roughly 6.7 times the 2014 net profit and 5.9 times the 2014 FCF per share (not discounting excess cash on the balance sheet).
In 2015, the regulatory uncertainty was much higher, and Plus500 had yet to expand to new geographies (such as South Africa), so it can be argued that buying Plus500 at today's price at an annual run rate of $180M net profit (a multiplier of 6.5) and an annual run rate of 160M FCF (a multiplier of 7.3) is not that far from the distressed offering.

Primary risk factors

We believe that the major risk factor for investment in Plus500 is expected change in the international regulatory frameworks regarding the trading of CFDs. A drastic regulatory change could limit the attractiveness of CFD's for traders. Change could also be very dramatic, such as making CFD trading platforms illegal; however, we believe that such a scenario has a low probability of occurring.

A second risk, associated with regulation, is the potential for Plus500 to lose its license from a regulator in a geography in which the company operates. This would limit Plus500's ability to offer services in that geography. We believe in low probability for this scenario, too.

Conclusion

We believe that at current price levels, Plus500 offers a good risk/reward ratio and a compelling investment opportunity with a price target of £11.59. We also believe that The recently updated buyback program announced early August 2017 should serve as a near term catalyst for price appreciation.

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