

And....It's Gone!

Presentation on Plus 500

May 3rd, 2018

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Philadelphia Financial Introduction

- Founded in 2004 by Justin Hughes and Jordan Hymowitz
 - Financials focused L/S equity manager based in San Francisco, CA
 - Covered financial services for 24 years
 - AUM over \$600M

The author is net short PLUS LN at the time of this presentation. In addition, the author's officers, directors, employees and/or principals (collectively "Related Persons") may have positions in and may, from time to time, make purchases or sales of the securities or other investments discussed or evaluated in this presentation.



Short Idea Philosophy

- In general, our best short ideas have been companies that rely on deceiving customers to make profits
 - ❖ If deceiving clients, the company is likely deceiving investors as well
 - ❖ If the business is ripping people off, that typically does not change when they are dealing with investors
- FXCM Example:
 - ❖ Filed a comment letter to the SEC on the retail FX industry in August 2011
 - Link: <https://www.sec.gov/comments/s7-30-11/s73011-10.pdf>
 - ❖ Swiss Franc de-pegging led to massive client losses that pushed the company in breach of regulatory capital requirements in January 2015
 - ❖ The National Futures Association (NFA) banned FXCM in February 2017 from membership due to “numerous deceptive and abusive execution activities that were designed to benefit FXCM, to the detriment of its customers”



Our Case Study

- Our case study is a short position on Plus 500 (PLUS LN), a leading Contract for Difference (CFD) provider:
 1. We believe the business model strategy of deceiving low-end retail clients is unsustainable
 2. Recent regulation around lowering leverage limits could hit earnings per share (EPS) by 50%+
 3. We believe the recent results have benefited greatly from cryptocurrencies, which have recently been faced with an advertising ban and seen lower volatility



How A CFD Is Sold



Source: YouTube



How Does A CFD Work



Source: www.youtube.com/watch?v=TGwZVGKG30s&t=2s



Plus 500 Client Trades Do Not Last Very Long

- Most client trades lasts less than 1 hour
- By comparison (Average length of time):
 - NFL football game: 3 hours, 8 minutes, 38 seconds
 - MLB baseball game: 3 hours, 5 minutes, 11 seconds
 - NBA basketball game: 2 hours, 15 minutes, and 30 seconds
- Average client life at Plus 500 ~15 months
- Global regulators have generally estimated 75%-85% of clients lose money on an annual basis
- Percentage chance of consumer losing money for casino games over 124 attempts by comparison:
 - Roulette (Red or Black): 72%
 - Blackjack (Basic Strategy): 58%
 - Craps ("Come Out" & "Pass Line"): 56%

*assumes 124 attempts to make on comparable basis to CFD annual activity rates



When We Say GONE, We Mean GONE

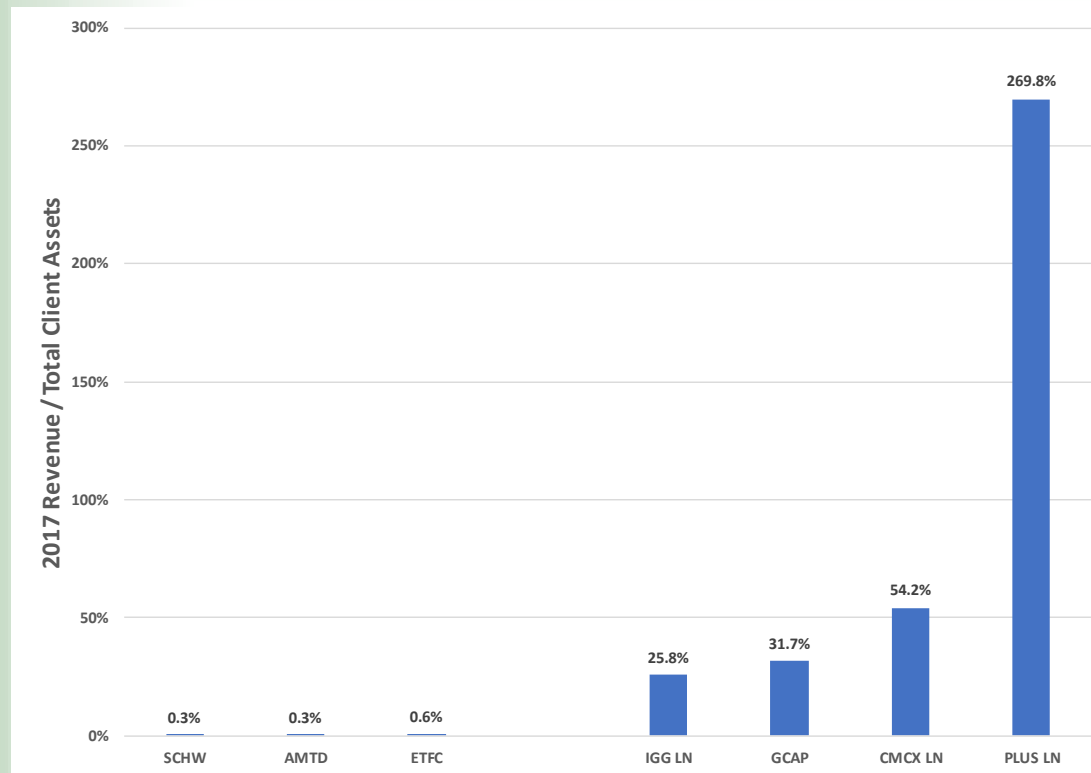
- According to the FCA (U.K), 76% of retail customers lost money over a 12-month period
- According to the AMF (France), 89% clients lost money over a 4-year period
- According to ESMA (Europe), 74%-89% of clients across EU jurisdictions lost money on their investments
- According to KNF (Poland), 79% of clients lost money trading in 2016
- According to Finanstilsynet (Norway), 82% of clients lost money over a two year period

Summary: Results for consumers are disastrous



How Expensive Are These Trading Products?

Plus 500 is a outlier in how much they make per client dollar in assets



Note: IG Group represents period end 11/30/17; CMC Markets represents period end 9/30/17
Source: Company reports.



Comparing European CFD Providers

Average account size and loss rate vary greatly across the industry

<u>Name</u>	<u>Ticker</u>	<u>Market Cap (\$M)</u>	<u>Client Assets (\$M)</u>	<u>Avg. Client Loss Rate</u>	<u>Average Account Size</u>
CMC Markets ¹	CMCX LN	\$741	\$462	35.2%	\$9,907
IG Group ¹	IGG LN	\$4,316	\$2,861	20.5%	\$18,835
Gain Capital ²	GCAP US	\$359	\$750	24.1%	\$9,361
Plus 500	PLUS LN	\$2,146	\$162	73.0%	\$724
Median:				29.7%	\$9,634

Note: CMC Markets as of 9/30; IG Group as of 11/30. Average client loss rate calculated as last twelve month revenue divided by the sum of beginning of period client assets and deposits.

¹Utilizes half year active account statistic

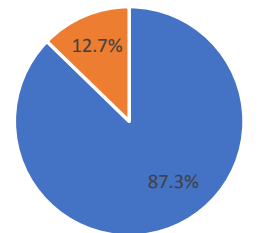
²Denotes retail stats

Source: Company reports.

What Is Wrong With This Ratio?

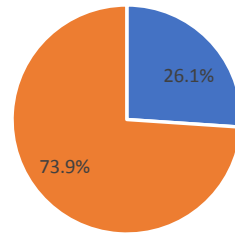
- Plus 500 marketing as a percentage of expenses dwarfs peers

Plus 500 Expense Mix



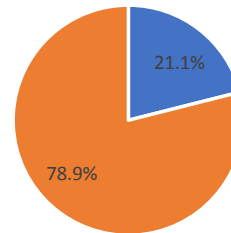
■ Marketing ■ Non-Marketing

Gain Capital Expense Mix



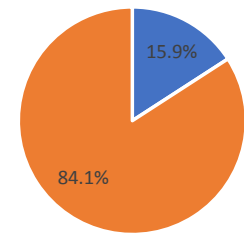
■ Marketing ■ Non-Marketing

IG Group Expense Mix



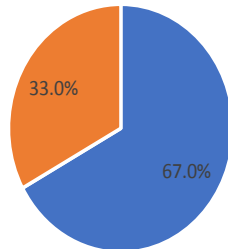
■ Marketing ■ Non-Marketing

CMC Markets Expense Mix



■ Marketing ■ Non-Marketing

Timeshare Industry (Bluegreen) Expense Mix



■ Marketing ■ Non-Marketing

Plus 500 is skewed toward a higher percentage of marketing than even the Timeshare industry!

Source: Company reports.

Who Is Plus 500?

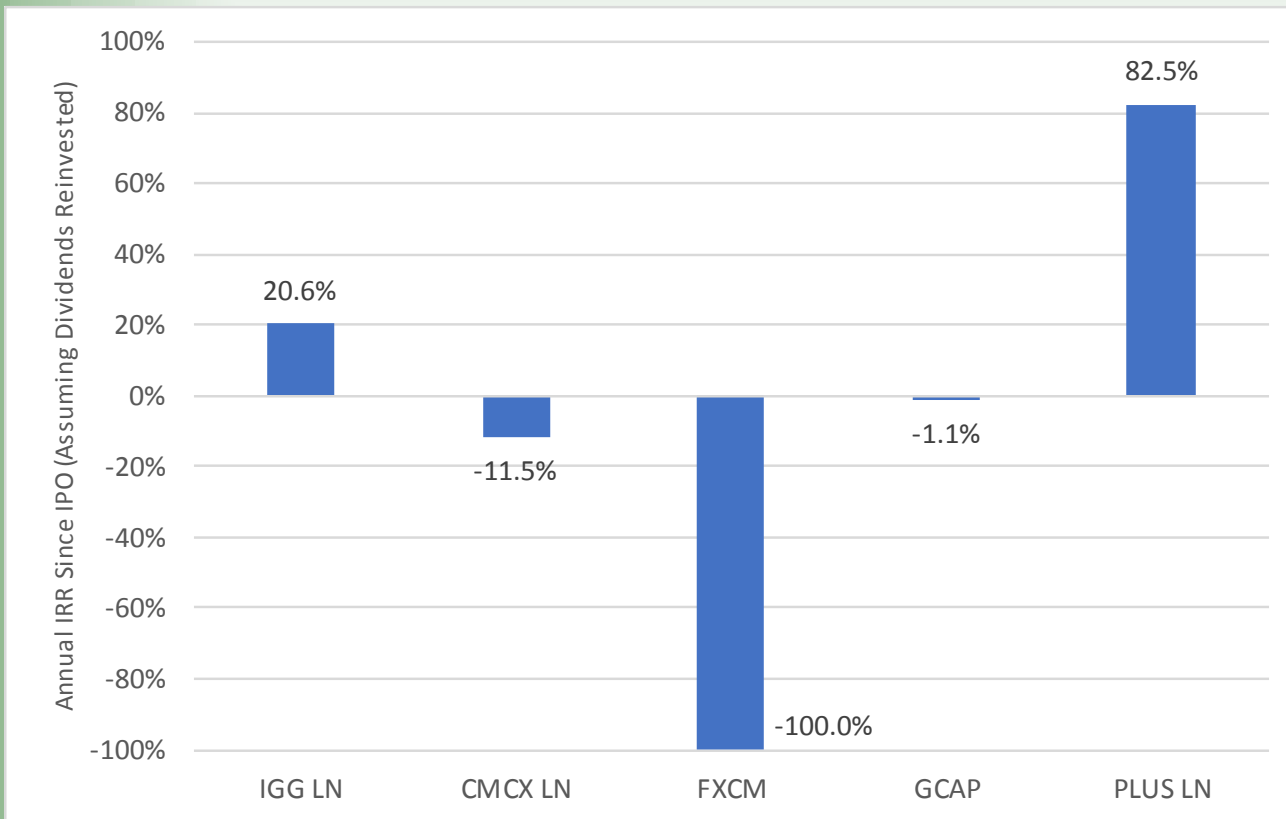
- 5th largest company listed on AIM, the second tier market of the London Stock Exchange; Headquartered in Haifa, Israel
 “Investors (have been) warned about putting money into small companies as one in ten firms listed on AIM have lost 90%” - ThisisMoney.co.uk (December 23rd, 2014)
- We believe Plus 500’s success has come from targeting an underserved segment of the market: the unsophisticated low-end not currently serviced or targeted by established firms
 - ❖ Lowest average account size at \$724 per account
 - ❖ Highest client loss rate at 73%
 - ❖ Highest percentage of marketing (of total expenses) at 87%
 - ❖ Highest exposure to cryptocurrency

Key Quote:

“Unlike traditional players – who are caught between two stools trying to appeal to both professional traders and a retail audience – Plus500 went straight for amateur investors’ – Business Insider



Plus 500 Stock Return Has Materially Outpaced Peers



Source: Bloomberg LP



Plus 500 Knowledge Test Nearly Impossible to Fail

- Investor knowledge test during account opening is only three questions:
 - First question requires a 2nd grade level of math (i.e. $1,000 \times 10 = 10,000$, not 300 or 20,000)
 - Second question is a multiple choice question with two options asking about a stop loss (allowed to ask the chat helpline for assistance in answering)
 - Third question is a multiple choice question with two options asking if the applicant knew who was responsible for adding money if they are margined out of a position (Plus 500 or the applicant)

Applicants are given 5 attempts to pass the knowledge test!



Are These Appropriate CFD Customers?



	<u>Case Study #1</u>	<u>Case Study #2</u>	<u>Case Study #3</u>	<u>Case Study #4</u>
Occupation:	Student	Retired	Taxi Driver	Unemployed
Age:	20	90	40	48
Residence:	Dorms	Barking, London*	Hostel	Dublin
Industry Experience:	None	None	None	None
Trading Experience:				
- Stocks	None	None	None	None
- OTC Derivatives	None	None	None	None
- Listed Derivatives	None	None	None	None
Investment Knowledge:				
- Leverage Question Requiring Single Digit Multiplication (i.e. $1 \times 1 = 1$)	Correct	Correct	Correct	Wrong
- Stop Loss Question with Two Choice	Correct	Wrong	Wrong	Wrong
- Close-Out Question with Two Choices	Correct	Correct	Wrong	Wrong
Income	0	£15,000	50,000.00 zł	0
Savings	0	£5,000	0	0
Source of Funds	Student Loans	Pension	Income	Government Benefits
Amount able to lose	£100	£100	500.00 zł	£100
Frequently to trade	Daily	Weekly	Daily	Monthly
Why	Intra-day Trading	Capital Preservation	Intra-day Trading	Speculation
Leverage Extended	180 to 1	180 to 1	180 to 1	180 to 1

**Profile of hypothetical
Plus 500 accounts**

*Named the poorest Neighborhood in London

Note: 50,000 zł = ~\$15,000



Globally Regulators Are Catching On

2009:

- Japan (FSA) lowered leverage limits to 50:1 on FX

2010:

- U.S. (CFTC) reduced FX leverage to 50:1

2011:

- Japan (FSA) lowers leverage limits again to 25:1 on FX and 10:1 on indices

2013:

- Japan (FSA) introduces a new knowledge test for binary options

2016:

- France (AMF) has issued restrictions on electronic marketing of CFDs to retail clients

2018 (Europe Awakens):

- U.K. (FCA) published a Dear CEO letter detailing observations of “flawed due diligence” for new distribution relationships
- EU (ESMA) rules will lower leverage as of **June 2018**
 - 3-month trial, expected to be made permanent

Global regulators are focused on customer “outcomes”. If loss rates do not decline, we would expect more regulation.



Coming June 2018: ESMA Rules Likely To Impact Plus 500

- EU (ESMA) rules require huge declines for Plus 500's leveraged offering:

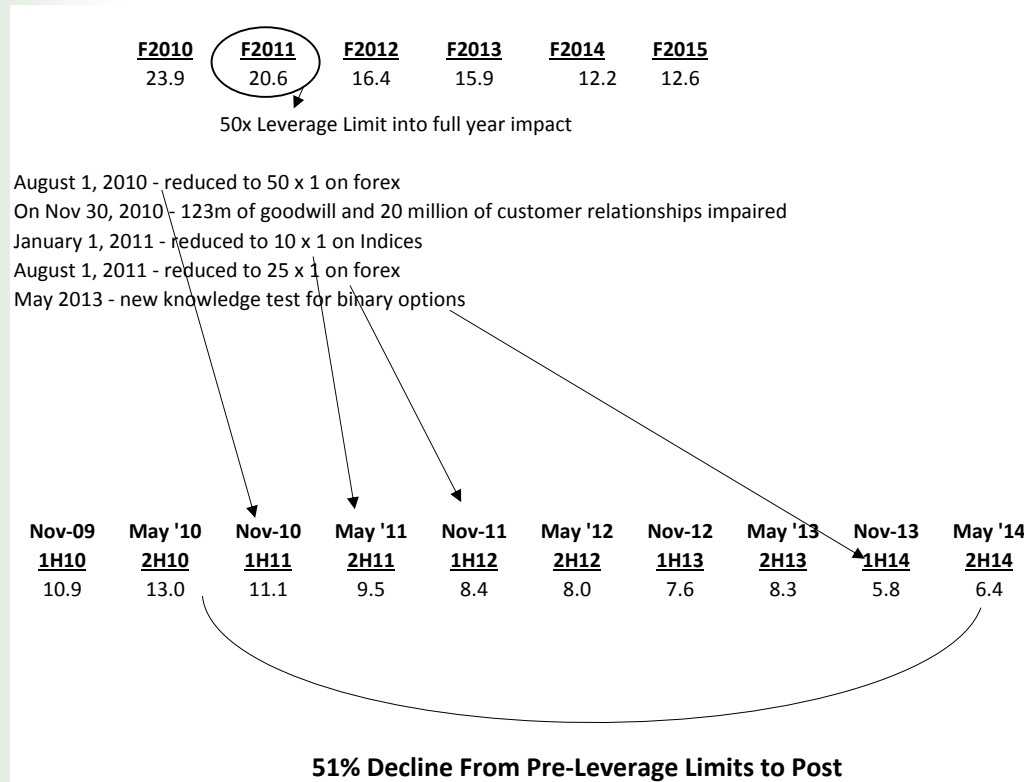
<u>Product</u>	<u>Plus 500</u>	<u>% Δ To Wipe Out Account</u>	<u>Approximate LTM Daily Volatility</u>	<u>New ESMA Leverage Limits:</u>	<u>% Decline</u>
FX Pairs	300:1	33 bps	~66 bps	● 30:1	90.0%
Indices	300:1	33 bps	~75 bps	● 20:1	93.3%
Commodities	152:1	66 bps	~2%	● 10:1	93.4%
Equities	20:1	5%	~2% - 10%	● 5:1	75.0%
Cryptocurrencies	20:1	5%	5%+	● 2:1	90.0%
<u>Plus 500 Policy</u>			<u>New ESMA Rule:</u>		
Offers deposit bonuses			Incentives restriction to trade CFDs		
No clear disclosure on client loss rates			Risk warning with % losses for clients		

Source: Plus 500 disclosures, ESMA.



Fortunately, We Have An Example Of Lower Leverage Regulation

Regulation In Japan Proved To Be Disastrous For IG Group's Japanese Business

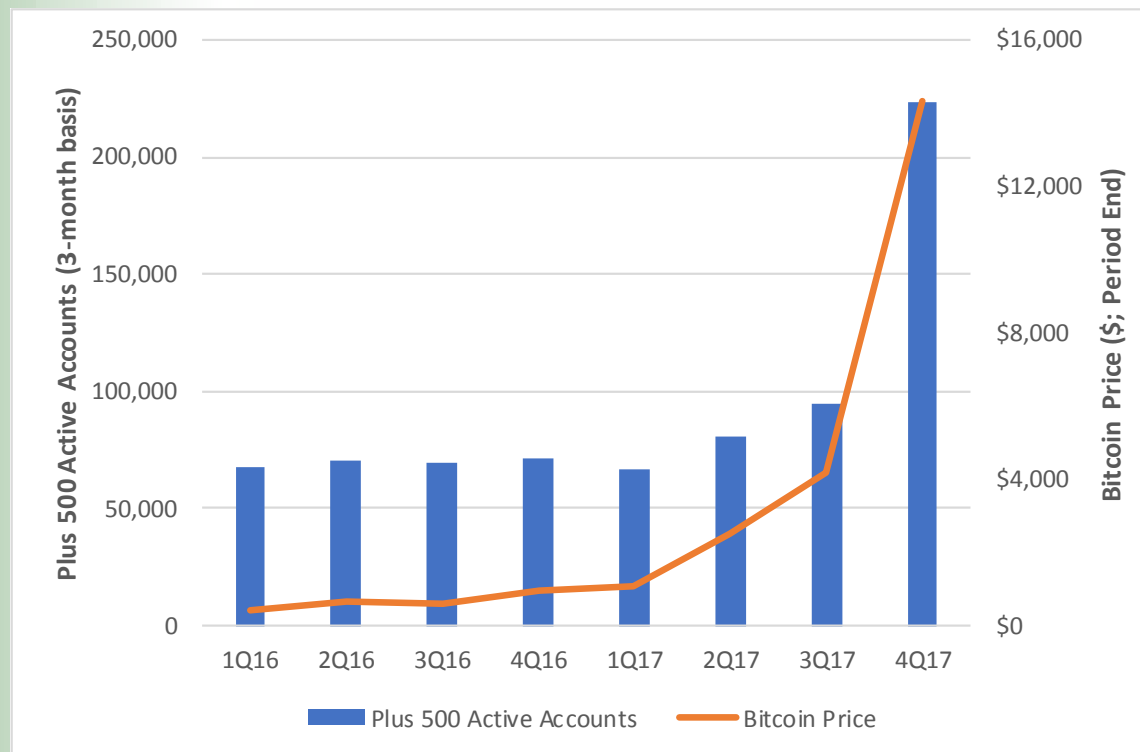


Source: IG Group company reports



Plus 500's Recent Growth Bolstered By Cryptocurrency

We believe 4th quarter new active account spike due to cryptocurrency



Source: Plus 500 company reports



Advertising Ban On Cryptocurrency

Notable bans on cryptocurrency in 2018

- Facebook: January 2018
- Twitter: March 2018
- Google: Effective June 2018

Plus 500's hallmark is effective online advertising (66% of 2017 marketing spend was online)

We estimate cryptocurrency was nearly all (90%+) of 2H17 revenue growth over 1H17

- Plus 500 cryptocurrency exposure “less than 15%” of 2017 revenue
 - Assume 1H17 cryptocurrency ~5% of revenue
 - Therefore, Cryptocurrency revenue in 2H17 = ~\$56M while revenue was up \$60M 2H/1H



Why Have The Stocks Not Sold Off?

- ESMA regulation has left a carve out for “professional traders” as defined by the FCA
 - To be deemed a “professional trader” one must have two (2) of three (3) qualifications:
 1. €500k investment portfolio (including cash and financial instruments (not real estate));
 2. Work in a Financial Services role requiring knowledge of CFDs, spread betting or trading FX work experience of at least 1 year
 3. Traded CFDs, spread betting or FX an average of 10x in each of the last four quarters
- However, keep in mind, Plus 500 built its business by targeting the low end of the market – therefore, the majority of clients will not qualify. IG Group has already approved 25%+ of its business to meet the professional definition. Plus 500 has converted zero as it does not even have a process in place.

Key Quotes:

“We identified a number of firms that accepted weak answers or asked inadequate questions to assess whether a client could opt up to elective professional status” – January 10, 2018 FCA Letter

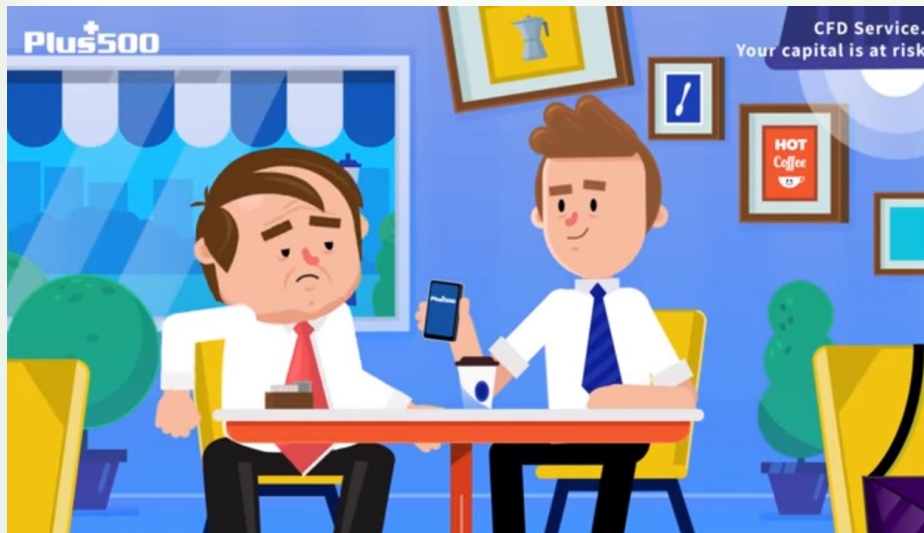
“Firms should request facts and information to support their assessment of a prospective client’s expertise, knowledge and experience in ways that gives them reasonable assurance” – January 10, 2018 FCA Letter



Plus 500 Is Clearly Advertising To Retail Investors



Source: youtube.com/watch?v=YCgpxNq346g



22 Source: youtube.com/watch?v=UtPHMuhGprE



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Public Statements Differ Among Industry Players

- Gain Capital (GCAP US) has noted they expect a 5% hit to 2018 full year revenue as a result of ESMA's regulation
 - This is broken down as follows:
 - 40% designated as professionals
 - 2018 will only have about a half year impact
 - Europe is 50% of total
 - **Net/Net: Assumes non-professional revenue will decline 30%-40% on a full year basis**
- IG Group (IGG LN) believes “well over” half of clients will be classified as professional, but did not update investors recently by quantifying the revenue impact. Previously, the company noted “if ESMA proposals had been in place in the previous financial year, (they would expect) a reduction in revenue of less than 10%”.
 - This is broken down as follows:
 - 50% designated as professionals
 - **Assumes 25% decline in retail**
- CMC Markets has not quantified impact, but noted they will provide an update in June
- **Plus 500: Despite a much larger exposure to retail clients and ~3x the industry loss rate, Plus 500 has not commented on ESMA impact**

Plus 500 Has A History Of Ignoring Regulation

- In Early 2015, Plus 500 had to freeze accounts when the FCA reviewed the company's anti-money laundering checks (or lack thereof)
- Shares fell ~67% in the days after the news was revealed



Source: Bloomberg LP



Founders Exiting Before Regulation

- The founders sold roughly 1/3rd of their holdings in front of new leverage limits

ESMA announces preparatory work on CFD industry

Plus 500 founders sell ~1/3 of holdings

ESMA proposed leverage limits announced



Source: Bloomberg LP



Timing Could Not Be Better

- Plus 500's new accounts and deposits surged in 4Q chasing the cryptocurrency euphoria and were subsequently wiped out in 1Q providing Plus 500 with a record revenue quarter
- Keep in mind, Plus 500 generates revenue as clients lose money
- 2Q Results: We expect a return to normalized levels
- 3Q Results: We expect the first signs of pressure from ESMA's new leverage limits for retail customers



Could This Be The Next FXCM? Leverage + Regulation

- FXCM was known as a marketing machine with more effective client acquisition models than peers driving the market cap of the company well over \$1B



- Gain Capital purchased FXCM's U.S. accounts at a blended rate of \$375 per account in early 2017
 - Assuming \$375 paid for each Plus 500 account results in a market cap of \$119M (or £87) versus \$2.2B (or £1.6B) currently

Appendix

- Plus 500 leverage offered by product:

Trade on 50+ Forex Pairs with Leverage

Trade forex with up to 1:300 leverage. With as little as \$100.00 you can gain the effect of \$30,000 capital!

[View our Forex pairs](#)

Trade Indices with Leverage

Magnify the size of your trades without committing large amounts of capital. Up to 1:300 leverage allows you to start trading with as little as \$100.00 to gain the effect of \$30,000 capital!

[View our indices](#)

Trading Commodities with Leverage

Commodities are available for trading at Plus500 with up to 1:152 leverage. You can start trading with as little as \$100.00 to gain the effect of \$15,200 capital!

[View our commodities](#)

Trade Popular Shares

Trade shares like Lloyds, Apple and Tesla Motors. Take advantage of falling or rising markets by opening Sell or Buy positions.

[View our shares](#)

Trade Shares with Leverage

Flexible trading in share CFDs. Leverage of up to 1:20 leverage allows you to start trading with as little as \$100.00 to gain the effect of \$2,000 capital!

Trade ETFs with Leverage

Trade on the ETFs market with up to 1:100 leverage. You can start with as little as \$100.00 to gain the effect of \$10,000 capital!

[View our ETFs](#)

Trade Cryptocurrencies with Leverage

Trade cryptocurrencies with up to 1:20 leverage. You can start with as little as \$100.00 to gain the effect of \$2,000 capital!

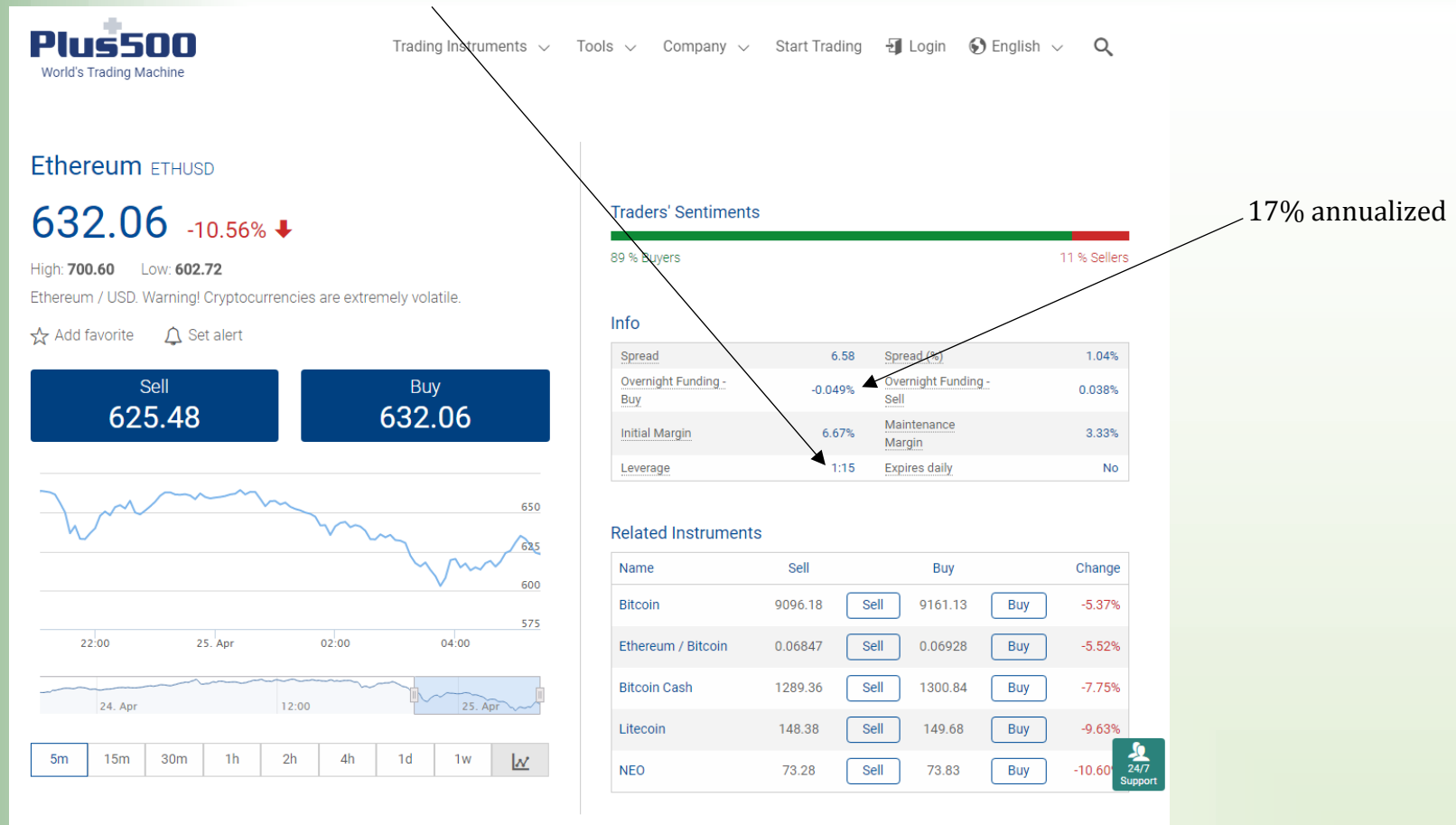
[View our cryptocurrencies](#)

Source: plus500.com



Appendix

- Plus 500 offering 15:1 leverage on cryptocurrency as shown below:



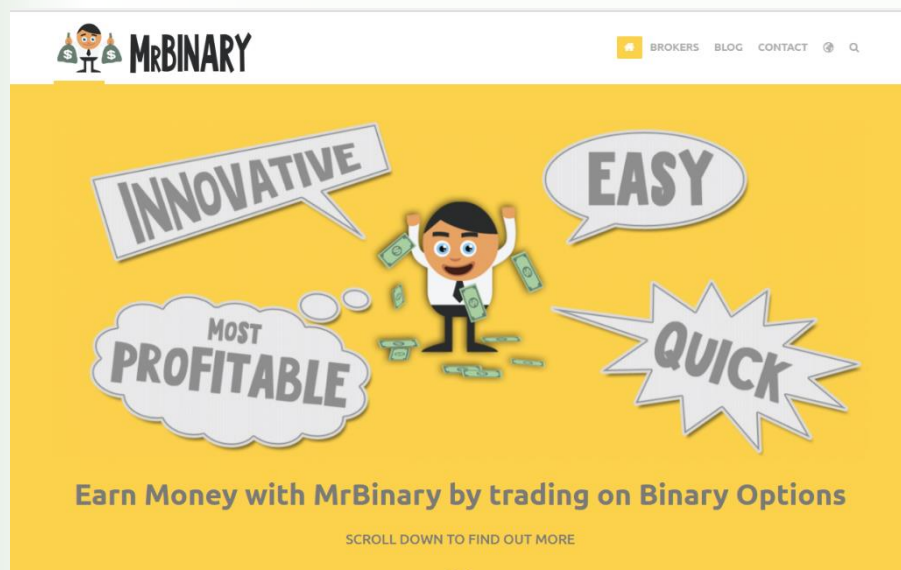
Source: plus500.com



Appendix

- FCA issued guidance seeking to curtail the use of introducing brokers without proper due diligence conducted

Example of the type of introducing broker used by Plus 500



Source: mrbinary.co.uk

- Marketing spend on affiliates tripled in 2017 from 2016



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Appendix

- Atletico Madrid “Plus 500” Jersey on sale for 50% off...are Plus 500 shares next to be 50% off?



NIKE ATLETICO MADRID HOME JERSEY 17/18 (RED/WHITE)

By Nike

\$ 45 ~~\$ 90~~

Source: soccerwearhouse.com



Disclosures

No Investment Advice

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