THE UK SHAREHOLDERS' ASSOCIATION INVESTIGATES AIM COMPANIES' ANNUAL REPORTS

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Annual Report for year ended 30 December 2015

INTRODUCTION

Plus500 introduces itself as a "*…fast growing online provider of Contracts for Difference ("CFDs")."* No attempt is made to tell us what a CFD is so Wikipedia has to be consulted to find that it is *"a contract between two parties whereby the seller will pay (or receive from) the buyer the difference between the current value of an asset and the value stipulated in the contract."* 'Assets' include shares, options, indices, currencies, commodities and exchange traded funds; they are essentially for short term trading not long term investing. The company is Israeli based and is highly profitable with excellent cash flow.

Progress was maintained in 2015 with sales increasing to US$276m (2014 $229m) but pre-tax profits took a dip to $128m ($138m) due to significant regulatory problems and an aborted takeover by Playtech – both dealt with below. Year-end cash was $156m, net of segregated customer deposits.

The dividend policy is for a 60% payout plus special dividends and/or, if appropriate, share buy-backs. Dividends are paid in US$ and, although not stated in the Report, smaller non-Israeli holders are subject to a 25% withholding tax which can be reduced to 15% by prior application to the Israeli Tax Authority.

THE REPORT

The report is clearly laid out in internet and hard copy format (sent promptly by the company on request). It is printed black on white (with blue headings) and the occasional display page or table printed white on blue. Including covers, there are 82 pages, of which 6 are blank and 10 are pictorial/title pages, including 2 announcing a recent marketing deal to sponsor Atletico de Madrid.

Plus500, whilst quoted on AIM, is not British, which gives rise to some differences in reporting. Thus, there is no information on directors' shareholdings, nor on the number of employees and employee remuneration. On the plus side, there is a useful Corporate Law section which is new this year, appearing fortuitously only 3 months before the Playtech deal was announced. (The Interim Report is unsatisfactory in that it is confined purely to figures and formalities, such as information on the regulatory problems; there is no comment whatsoever by the directors, which leaves shareholders unacceptably short of information.)

The report starts with a statement of the Highlights of the Year, before moving into the separate Statements by the Chairman and the Chief Executive Officer followed by the Financial Review. All these are informative, don't overlap unnecessarily and are pretty well jargon free except for the CEO's use of the phrase *"on-boarding processes"* when referring to the procedures followed in taking on new customers.

The statutory reports from the Directors, including Remuneration, Corporate Governance and Corporate Law take up a praiseworthy 13 pages. Remuneration takes only 2 pages because there are no legacy share incentive schemes for Directors, except for the Chief Financial Officer who was included in a small, short-term plan for employees which was introduced early in 2014 and is dealt with in a full page note.

The Auditors' Report is notably brief (possibly because of the Israeli domicile?) and the figures are clearly presented. The Notes do not contain any surprises, except perhaps that the Fixed Asset Schedules have been printed in landscape format which is awkward to read on-line.

Our criticisms of the Report, in addition to those appearing under Risk Management, are,

- The front cover says "*2015"* and we have to plough through to the Auditors' Report on page 47 to confirm that it is for the calendar year.
- There is the failure to answer the most basic question, 'What is a CFD?'
- There is no statement in the notes as to the number of employees and their remuneration.
- There is no analysis of the addressable world market, only a comparison with other UK listed CFD providers.
- It would be helpful for non-Israeli shareholders to have a clear statement in the Report that dividends are paid in US$ net of 25% withholding tax.

RISK MANAGEMENT

Plus500 acts as a principal in CFD trading and its Risk Management is thus at the forefront of the business. The main methods it uses to reduce risk are to accept only retail customers, to avoid unfunded customer losses by closing out, not to offer positions in illiquid instruments and to avoid high risk by hedging, as discussed in Notes 2 & 3 to the accounts. In 2015 there were 337 profitable days and 28 losing; the biggest day's gain was $5.7m and the biggest loss $0.7m.

On January 2015 the FCA began an investigation into the UK division's new client registration procedures particularly under anti-money laundering legislation. It would certainly seem that shareholders should have been informed promptly but, although the Annual Report for calendar 2014 was issued on 16 March 2015, the investigation was not mentioned and it was not until rumours started that a holding announcement was made on 18 May. On 22 May the shares were suspended temporarily to allow for a full announcement. The share price fell by 50% in May and has only now, over a year later, regained former levels. Management was strengthened and registering new UK customers was resumed in January 2016. We find the report unacceptably lacking in its explanation of these events, of the Board's accountability and of what steps have been taken to prevent a recurrence. It was surely a shocking experience for investors so a full explanation should have been given in the report, not what looks like a PR exercise to gloss over the failures.

On June 1st 2015 Plus500 announced an agreed takeover by Playtech plc. The intention was to complete the deal before the end of December; the parties could not meet the timescale and the deal foundered, having doubtless taken a lot of management time at a critical period.

THE BUSINESS & ACCOUNTS

The company's Strategic Objectives are clearly stated, with the first one being *"Maintaining our Market Position as a leading CFD supplier"*; the others all follow from this. Of rather more interest are the Key Performance Indicators,

1. Number of Active Customers. Up 29% from 105,976 to 136,540.
2. Number of New Customers. Up 27% from 66,533 to 84,858.
3. Average Revenue per User. Down 6.5% from $2,160 to $2,019
4. Average User Acquisition Cost. Up 33% from $921 to $1,227.

The first point to note is the high rate of churn, with 62% of active customers being new in the year. Secondly, due to the temporary ban on UK enrolment, all the new customers must have come from other markets. The cost of acquiring these new customers was 45.5% of total revenue against a mere 8% for admin and financial costs (leaving 46.5% for pre tax profit). The company is *"comfortable"* with these enrolment costs because they are taken up-front and there are systems in place to vet new customers to ensure that, in aggregate, they yield 100% return on investment.

The Balance Sheet is equally simple with no intangibles and total assets of $169m being mostly cash ($156.5m, held with 5 banks, rated between AA- and A-). On the liabilities side, total equity is $117.7m and otherwise the largest number is the outstanding dividend of $24.4m. The balance sheet shows a tax liability of only $7.8m whilst the trading statement shows a charge of $31.3m (all figures include, where appropriate, very minor adjustments for deferred tax), with tax actually paid in the year of $42.7m. Since the balance sheet tax liability at 31/12/14 was $19.1m net, we must assume (as supported by reported Cash Flow) that a large proportion of the tax on 2015 profit was paid before the year end. If so, why?

In November, when the Playtech deal fell through, a share buy-back programme was announced. However, tucked away in the Directors' Report is the statement that, in the light of the subsequent share price increase, the buyback has not been activated and the directors will keep the situation under review.

DIRECTORS, EMPLOYEES & SHAREHOLDERS

Seven directors served for the year, 4 non-executive and 3 executive; there was 1 female, the Chief Financial Officer. Remuneration was $326k for the non-execs and $771k for the execs. There have been several board changes in recent months.

Plus500 is unusual because 5 of the company's founders work in the business (only 1 being a director) and earned a total of $1,448k. They held 35.6% of the equity with institutions holding 37.1%: included in this latter figure is a 9.9% holding by Brighttech Investments, an associate of Playtech.

As stated earlier, there is no information about employees and , most unusually, neither the Chairman nor CEO says 'thank you'. The only clue we have is from a breakdown of costs in the notes which shows a payroll and related expenses of $11.3m. This can be compared with bought in selling and marketing expenses, including commissions and advertising, of $120m.

We must conclude, as the profits show, that (financially) the company is tightly run with as much work as possible delegated to third parties, leading to a highly resilient cost base.

CONCLUSION

A readable report covering an unusual and profitable company which let its shareholders down in 2015 by failing to meet regulatory requirements and then bungling the announcement. Overall it is difficult to escape the conclusion that the directors regard the company as their own and that outside shareholders must come in on those terms.

HPB 04/09/2016