Travis Wiedower, Founder, travis@wiedowercapital.com

Interactive Brokers is an automated electronic broker-dealer. Because they automate virtually everything they do, their cost structure is lower than their competitors. This results in Interactive Brokers having the lowest prices in the brokerage industry, yet they still have the highest margins. Interactive Brokers also has far fewer conflicts of interest than their competitors. All orders are sent directly to the exchanges or internally matched between clients. They don't sell orders (like the retail brokers) and they don't trade against their own clients (like the big banks).

One thing I really like about Interactive Brokers is they have come to dominate a small niche of the investing world and are now focused on expanding that niche (I talked about this concept in my Where Food Comes From write-up as well). Their strong market share among small, professional investors gives them a stable base of profitable business to grow from. They estimate they have around 25% market share of proprietary trading groups and 15% of sophisticated individual traders. Their share of the overall hedge fund and investment advisor space is very small, but I believe their share of small funds (less than $20 million in assets) is significant. Preqin (a valuable industry resource) lists Interactive Brokers as the #2 most utilized prime broker for hedge funds under $50 million in assets, but if this segment was broken down more I bet they'd be #1 for the smallest of funds. Anecdotally, well over 50% of the small fund managers I talk to use Interactive Brokers. And most of them say they use it because "there were no other options." And it's true, if you're starting a small fund, the big banks don't want you and the mini-primes and retail online brokers have worse pricing.

So the majority of small funds start on Interactive Brokers, which has a very sticky business model. It's not uncommon for large funds to have a couple prime brokers (a little less than 50% of funds use two or more prime brokers), but small funds are more likely to use one prime broker and switching is a hassle. According to Preqin, just under 12% of funds changed prime brokers in 2015. I believe these two traits (most small funds start on Interactive Brokers and a sticky business model) are going to result in a long-term flywheel effect that sees them continue to take market share. As those small funds grow, a significant portion should stay with Interactive Brokers which will improve borrow availability and thus attract other larger funds. This will be a long, gradual process but I do think it has already begun. As of October 2016, they had 34 accounts with over $100 million in them. From conversations I've had, there are at least a couple funds in the low single-digit billions that use them. Preqin claims "Interactive Brokers services 10% of funds launched in 2016, representative of a growing client base; the firm currently services 5% of all hedge funds."

A fully-automated broker is also a very scalable business model. Interactive Brokers can profitably take on small clients that the big banks refuse because their fixed cost for each additional client is so low. Their brokerage pre-tax margins scaled from 34.2% in 2004 to 60.2% in 2016 and they think they can keep growing this number into the low 70s.

I ran across an article online last year that talked about ten attributes the highest quality companies have. None of the ten will surprise anyone, but it's pretty telling to go through the list for Interactive Brokers:

1. Sustainable competitive advantage – technology is ahead of their competitors who have way more overhead. Evidence of this technology advantage is their low cost and best execution.
2. Network effects – I think they're in the early innings on this point, but I'll discuss several network effects that can develop in the future.
3. Predictable earnings – professional investors and active traders are going to continue to trade until they go bust or close up shop.
4. High switching costs – changing brokers is a hassle (similar to changing where you bank at). I've talked to managers who have changed their one prime broker and it's not a fun process. Evidence of this is their low churn rate.
5. High gross margin – hell, their pre-tax margins are over 60%.
6. Scalability – pre-tax margins have scaled from 34% to over 60% and they think they can get to the low 70s.
7. Customer concentration – none.
8. Major partner dependencies – none. They build and maintain their own platform.
9. Organic demand vs marketing spend – until about a year ago, Interactive Brokers grew completely by word of mouth. They've started doing a little marketing because they're frustrated the company isn't growing faster.

10. Growth – 10-20% the past few years. While I'm modeling growth to slow in the future, I wouldn't be surprised at all if it sped up (account growth actually has sped up the first six months of 2017).

Management

Thomas Peterffy is the founder, Chairman, and CEO and owns around 75% of shares. Normally I don't like investing in majority-owned companies, but Peterffy is an exceptional case. He came to America as a poor Hungarian immigrant knowing zero English and became a self-made billionaire. He's run the company since 1977 when his life's mission of making Wall Street more efficient began. I appreciate that he's been very clear in his goals for Interactive Brokers for a long time. He wants to build the biggest, cheapest, most efficient broker in the world and he's been consistent in that message for many years. Here is a notable quote from a recent presentation he gave:

"I always wanted to become the biggest broker and before I die, it will be… We will never do capital introductions. We will never bring CEOs together with potential investors because we will never do the things that we cannot automate, we are a bunch of computer programmers, and that's what we do."

Analysts have pushed him to offer cap intro (and other more labor-intensive services), but he always refuses . He has a clear vision of what he thinks Interactive Brokers should be and he really hasn't strayed from that. Analysts constantly ask him about returning capital, but he won't do it because he wants to ensure Interactive Brokers has the safest balance sheet of any broker in the world. Finally, Peterffy stuck with requiring two-factor authentication even though they lost clients over it. He believed increased security was more important and that ultimately he was protecting his clients. If you're not familiar with Peterffy, I highly recommend listening to their conference calls or watching his past interviews. Their conference calls are always my favorite to listen to.

Competition

Interactive Brokers mainly competes with the big banks (JPMorgan, Goldman Sachs, Morgan Stanley, Citibank, etc) and the big online retail brokers (Schwab, TD Ameritrade, Fidelity, E-Trade, etc). Their one direct competitor (in terms of an automated electronic broker-dealer) is Saxo Bank. Right now, Interactive Brokers has significant market share among small professional investors and serious individual investors. The big question now is if they can move upmarket to compete with the big prime brokers for larger hedge fund clients. As of late 2016, their average hedge fund client only had around $2.2 million in equity in their account, so you can see they have a long way to go (and a lot of opportunity). There are notable differences between Interactive Brokers and each group of their competitors (big prime brokers, retail brokers, Saxo Bank) so I'm going to talk about each separately.

Interactive Brokers vs big prime brokers

OTC derivatives and cap intro
Interactive Brokers doesn't offer custom trades whereas a big bank will give a hedge fund client a trade on just about anything. Interactive Brokers also doesn't do cap intro, though they are trying to offer this service through their Covestor platform. Covestor allows qualified investors to easily invest in any money manager who uses Interactive Brokers. Covestor is still a miniscule part of their business, but I like that they're trying to automate things that aren't traditionally automated. Back to the point, I do think Interactive Brokers can successfully move upmarket in the hedge fund space without offering over-the-counter derivatives and cap intro. A little less than 50% of hedge funds have two or more prime brokers so I think it's reasonable that hedge funds can use a big bank as their main prime broker and Interactive Brokers as their secondary broker (which some are already doing). Being a big prime client isn't mutually exclusive with being an Interactive Brokers client. Also, it's possible Interactive Brokers figures out a way to automate things like OTC derivatives and credit default swaps at some point in the future.
Leverage limits

Interactive Brokers has stricter leverage limits for hedge funds and they're much quicker to automatically close out trades if they get too risky. Not surprisingly, automatically closing out a client's trade has the tendency to piss them off. While not offering the high leverage limits that big banks do will decrease the number of hedge funds that will consider using Interactive Brokers, I think it's a fair trade-off. Not providing special leverage to clients and automatically closing out leverage positions if they become too risky is part of the reason that Interactive Brokers as a whole is cheaper and safer than their competitors. It's also important to note that the average gross leverage for long/short equity hedge funds seems to be around 1.3 to 1.5, which is within what Interactive Brokers allows.

Borrow availability
Another tangible difference is the availability and quantity of stock to short. Given 35% of all hedge funds are long/short equity, how much stock is available to borrow is an important part of growing their hedge fund business. Right now, Interactive Brokers sources most of their borrow internally from their own clients. This is good because it's higher margin than borrowing from an outside security lender, but it won't be enough to handle larger long/short hedge fund clients. Alternatively, Interactive Brokers can go to an institutional security lender for more borrow availability. As of now, the big banks have significantly larger borrow demands and thus better relationships with the institutional security lenders. This should provide them better borrow rates compared to Interactive Brokers.

Ideally, as Interactive Brokers grows their hedge fund business their ability to source borrow internally will increase and their hedge fund business will be big enough to get more competitive rates from institutional lenders. Borrow availability is subject to very strong network effects. Interactive Brokers is currently popular with small professional investors. If these small funds grow and stay on the platform and/or Interactive Brokers successfully attracts larger funds, more stock will be available to borrow. This makes Interactive Brokers more attractive to bigger funds and so on and so on.

Mini-primes
Similar to the big prime banks, another group of companies that Interactive Brokers competes with is mini-primes. For hedge funds that are too small for a big bank, they can go to a mini-prime. The mini-prime is a broker-dealer that handles all the front end customer service type stuff with the hedge fund client, but the trades are all routed to their big bank partner. Mini-primes have worse pricing than Interactive Brokers, but a lot of small funds find them valuable because of services like cap intro.

Interactive Brokers vs retail brokers

Structural difference
The traditional retail brokers like Schwab and TD Ameritrade have significantly more overhead than Interactive Brokers. Schwab has 335 branch offices in the US and TD Ameritrade has "over 100." On top of that, Interactive Brokers is automated and clears trades internally or sends them directly to the exchanges as opposed to all the retail brokers that sell their order flow to high frequency traders, which adds a layer of expenses. If you've ever used Interactive Brokers and a retail broker, I'm sure you've noticed the difference in execution. This is why. Combining the effects of lower overhead and not selling order flow, Interactive Brokers has significantly lower pricing than retail brokers.

Interactive Brokers and the retail brokers will continue to compete for financial advisors and semi-serious individuals, but I don't think there's any chance of the retail brokers ever duplicating what Interactive Brokers offers. As described above, the way the companies do business is completely different. For Schwab to really compete on pricing, they would have to fire thousands of employees, close down 335 branch offices, and hire a ton of programmers to build an automated platform from scratch. As Peterffy has said many times, the real difference is that retail brokers are run by salesmen, whereas Interactive Brokers is run by programmers.

Introducing brokers

Some of these retail brokers have realized they will never compete on price and execution with Interactive Brokers so they've become introducing brokers instead. The way an introducing broker relationship works is that the order flow from the retail broker's most active clients gets rerouted through Interactive Brokers who clears the trades. Interactive Brokers aggregates all clients from the same introducing broker to determine what pricing tier to charge. The introducing broker then takes a large cut of the commission and charges their client what they would have paid as a direct client to Interactive Brokers. So the broker's client is paying the same or less than they would if they were a direct client of Interactive Brokers, meaning they have no incentive to leave their current broker. The retail broker continues to handle all customer service aspects of the client relationship.

As you can imagine, introducing brokers are very high margin for Interactive Brokers since all they do is route the trades. This has been one of the fastest growing parts of the business (33% in 2016) and I expect this to continue. If you're a retail broker, it's better to make less money on your most active traders than it is to lose them entirely to Interactive Brokers. I believe Interactive Brokers has in the ballpark of 150 introducing broker clients and each one of those has a handful up to several thousand clients that they execute through Interactive Brokers.

This growing business accounts for why their average commission per cleared order and average number of trades per day per customer have been coming down. First, Interactive Brokers is clearing orders for a bunch of accounts at lower tiered pricing than those investors would be paying if they were direct clients. Thus, average commission per cleared order has come down. Second, clients from introducing brokers are not as active as direct Interactive Brokers users, so average number of trade per day per customer has also come down. On the positive side, these introducing broker clients are very high margin and the return on incremental capital required for each one of these relationships should be extremely high.

Peterffy has said many times that he doesn't want retail clients because they require far more hand holding. A client with a $50,000 IRA that buys and sells a few ETFs a year simply isn't worth it because they require more customer service help than hedge funds with millions under management. Not that Interactive Brokers turns these retail clients away, but they don't actively seek them out. I think the introducing broker setup is a great compromise. They get some of these less active traders to clear through them at very high margins, but all the customer service and backend crap is handled by someone else.

Saxo Bank

Saxo Bank is the only company I've found that I'd consider a direct competitor to Interactive Brokers. By that I mean Saxo is another automated electronic broker-dealer, but they also have a bank license (as their name suggests) and thus offer traditional investment banking services. Saxo was founded in 1992 and has remained privately held so I don't know a ton about them. I've also never talked to an investor who uses their online platform (which I guess is a good sign). An outside investment in 2011 valued the bank at around $1.4 billion. Just comparing standard commission rates on the two websites, Saxo is significantly more expensive than Interactive Brokers (2 cents/share for US stocks vs 0.5 cents/share). Interactive Brokers also offers access to over 120 exchanges around the world while Saxo only offers 36. I also think Interactive Brokers being US-based is a big advantage as 74% of the industry's AUM is based in North America vs just 20% in Europe (Saxo is based in Denmark).

Even though being US-based is an advantage, Interactive Brokers is very much a global company. For the past year or so, Asia has been the fastest growing area of their business. From what I can tell, this is because Interactive Brokers has a massive advantage against the local Asian brokers, in terms of cost, execution, and markets available to trade on. I expect this competitive gap will allow them to continue taking market share faster in other countries than in the US.

Tailwinds

Industry consolidation
The number of worldwide broker-dealers has declined every year since 2011 (from 4,456 in 2011 to 3,869 in 2016) and that trend is expected to continue. There are a lot of small independent broker-dealers that aren't reaching enough scale to handle the fixed costs and increased regulation of the industry. There is some risk here with Trump deregulation, but I don't think the trend of consolidation is going away. Of these 3,869 broker-dealers, only a few hundred clear trades, meaning a lot of the others are just middlemen who add expenses to the industry (some do add value).

Big banks firing small funds
Another result of increased regulation (like Basel 3) is that small funds are no longer profitable for big banks. This has resulted in a wave of small funds being fired from the big banks and having to find another prime broker (such as Interactive Brokers). Because Interactive Brokers is more efficient than these big banks, they can profitably take on much smaller clients.

Float increase
Interactive Brokers came public through a confusing structure called an Up-C partnership. The basics are that the pre-IPO owners are in a separate partnership entity (so they avoid the double taxation of a C-Corp) that results in a 15-year tax benefit (85% of which goes to the partnership and 15% benefits public shareholders). As of June 2017, this partnership entity owned 82.9% of the company and the public entity owns the other 17.1%. But as Peterffy and executives sell down their ownership over time, the public entity owns more of the corporation. Public ownership has gone from 11.5% in 2011 to 17.1% in mid-2017 and Peterffy has made some comments that this rate could increase in the future. Either way, each year the float will increase and as that happens the average daily volume of the stock will increase and thus the company will be put on the radar of more and more hedge funds. Right now, the public float is a little over $2 billion which is still considered a small-cap stock and therefore un-investable for large investors. It's also important to note that this structure makes share dilution look much worse than it actually is. Most of the "dilution" is just private shares going public.

Transition to a more automated society
I don't think anyone can argue that technology isn't going to continue taking over our lives. It's hard to imagine Wall Street (and brokers specifically) not being significantly more automated in ten years and Interactive Brokers has been leading that transition for a long time.

Transition to a more transparent society
Maybe not as obvious as the above point, but I believe we are also moving to a more transparent society. Similar to my Where Food Comes From thesis, consumers are demanding more transparency in the companies they buy from. People want to know where their money is really going. Interactive Brokers has led the charge on this front on Wall Street. They release far more information than their competitors on pricing, execution, and clearing costs. I think small stuff like this will build goodwill over the long-term. It doesn't take a rocket scientist to answer the question, "Why don't their competitors want to be as transparent as Interactive Brokers?"

Risks / bear case

Peterffy is 72 years old
Hopefully Peterffy is still sharp and running companies at 93 like Charlie Munger, but that's far from a guarantee. Milan Galik is the current President and has already been named as Peterffy's successor. Galik is 50 years old and owns around $15 million in stock. Peterffy pays roughly half of executive compensation in restricted stock units that grant over six years so the entire executive team is well incentivized by the stock price. Galik has been at Interactive Brokers since 1990 when he started as a software developer. Peterffy has said he's going to work as long as he is healthy because he

loves it, but Galik has already been taking over more responsibilities the past couple years, so I expect the eventual transition to be smooth.

Interactive Brokers isn't "too big to fail"
To many in the industry, Interactive Brokers is not viewed as being as safe as the big banks. As comical as I find this to be, it's unfortunately the truth. I've had numerous portfolio managers of large hedge funds tell me they can't use Interactive Brokers because their large institutional clients don't trust Interactive Brokers as much as a big bank. One of the main reasons Peterffy took the company public was to become more well-known and eventually viewed in line with the big banks. I think this image can go away via a long-term flywheel effect of being public and their float increasing, but it will take time. The longer they're public, the more people will learn they exist (I'm surprised how many in the industry either haven't heard of them or don't know they're public). As their float increases, they'll come on the radar of larger hedge funds that will then learn about them. As more people in the industry learn about them and see their overcapitalized balance sheet with zero debt, more people will view them as a safe broker-dealer. If institutional investors start to see Interactive Brokers in a more positive light, more hedge funds will be allowed to use Interactive Brokers as their prime broker.

Too levered to the economy
The clients of Interactive Brokers as a whole probably have a beta close to 1 (meaning their accounts move in line with the overall stock market). This means a downturn will decrease those AUMs which will decrease Interactive Brokers' revenue. Client equity per account started 2008 at $91k and fell to a low of $76k that year, but it quickly rebounded to $100k by August 2009 and has continued to go up ever since. Interactive Brokers makes money off volatility which has been quite low as of late and would probably increase during a downturn (especially the downslope of the downturn). Shorting may also increase. Also, it makes me feel better that their number of accounts grew every month during 2008 and 2009 (and every month since). If you look at their high level results since 2004, you wouldn't even know there was a financial collapse in there. While brokerage net revenue saw a small decline from 2008 to 2009, pre-tax income grew straight through the collapse.

Customer service
If you talk to any Interactive Brokers user, there's a good chance their #1 complaint will be customer service. I don't know if I've just been lucky, but I don't have any customer service complaints in the two and a half years I've been on the platform. Every issue I've had has been handled within a reasonable amount of time via live chat or a phone call. With that being said, enough people I've talked to have complained about customer service that it's clearly not one of their strong points.

Usability of platform
Another common complaint of users is the complexity of their platform. While it does take some time to get used to, I've come to like it a lot. The sign up process is also long and clunky, which can be a problem if you're managing separate accounts and every client has to set up a new account.

To address these last two issues, I think their churn rate would be much higher if their customer service or platform complexity were deal breakers. As of early 2016, their annual churn rate was just over 7%, but this overstates the number that we care about because the majority of that is small accounts that run out of money. Only around 1% of clients each year leave Interactive Brokers for another brokerage firm, but most of those are accounts that switch advisors to someone who manages money through a different broker. Thus, the annual churn rate of clients who leave Interactive Brokers because they're unhappy with the platform is less than 0.5%.

Trump deregulation
As mentioned before, this may delay or slow some trends, but I don't think the major trends that affect Interactive Brokers are going away. I don't see any reason to have nearly 4,000 broker-dealers in this industry longer term. I also

don't see how the most automated, lowest cost producer doesn't continue gobbling up market share, which they've been doing for many years.

Credit risk in their margin loans
Most recently, Interactive Brokers lost $121 million in 2015 when the Swiss unpegged the franc. In years prior they've had other similar events as well. Notably, there were no credit losses following Brexit. Peterffy has commented that the Swiss franc was a major mistake on their part and they've improved their controls to watch potentially market-dislocating events closer. Zero losses on Brexit makes me feel better. With that being said, I do think this is a part of the business and it will always be a risk. I accounted for this in my model by normalizing all the past credit losses and subtracting that normalized number ($20 million) every year going forward.

Market maker segment
I haven't even mentioned this other part of their business because, frankly, I don't care about it that much. At its peak in 2008 the market making division earned $1.3 billion in net revenue, but that has steadily fallen to $190 million in 2016 as it's struggled to compete with high frequency traders. I account for this segment by subtracting the market making capital in my enterprise value calculation and then valuing the broker by itself. They recently shut down all options market making activities which Mr. Market didn't seem to like, but I was never counting on this segment anyway. I suspect the rest will be shut down, sold, or spun out in the not-too-distant future.

Valuation

First, that overcapitalized balance sheet I've referenced a couple times. As of Q2 2017, they had $26 billion in cash and cash equivalents and zero debt. In their brokerage business, they have $3 billion more than regulations require. How to think about this excess capital is meaningful when calculating enterprise value. Peterffy has said numerous times he plans to keep all cash in the business for the foreseeable future because he wants to be viewed as safer than the big banks. But to anyone paying attention, their balance sheet is already far safer. On a relative basis, Interactive Brokers has more cash and less debt than all of their competitors (and they don't have derivative risk). Therefore, it is my opinion that they could pay out some of that excess capital and still maintain their image of an extremely safe broker-dealer and their growth rate wouldn't be harmed. Long story short, I subtract out half of that excess brokerage capital in my enterprise value calculation.

Looking at simple multiples, I prefer EV/NOPAT (or normalized NOPAT rather). As mentioned before, I normalize the losses they've experienced in margin loans and expense that going forward. I also normalize other income (mostly exchanges paying for order flow) and strip out currency effects. Finally, I find it easier to value the company as a whole (including the non-public holding company) as opposed to just the public portion. This probably slightly overstates earnings because expenses related to being a public company are wholly paid for by the public shareholders, but in a multi-billion dollar company the effect is small and should be made up for in other conservative assumptions (like the fact that I always use an 11% discount rate). With those assumptions, Interactive Brokers is selling for 21.5x my estimate of 2017 NOPAT. I think that's too cheap for this high quality of a company with a long growth runway in front of it. By the way, if no brokerage capital is considered excess then the 2017 multiple jumps to 24.8x—so definitely notable but not thesis breaking.

Getting into a more thorough valuation, a discounted cash flow for this business unfortunately involves making a lot of assumptions (about the opposite of my write-up on the very simple Calloway's Nursery). One reason I like using an 11% discount rate is because it's more conservative than any other models I've seen. As much as I try to be conservative and realistic when building a model, I think it's inevitable that I subconsciously make some aggressive assumptions. Building a model for Interactive Brokers requires making guesses at their future commission rate per cleared order (which has bounced around a lot in the past), trades per client per day, where interest rates are heading, how much they'll earn on credit balances, how much margin future clients will use, and so on. Nonetheless, below are the key assumptions in my discounted cash flow:

1. Account growth steps down every year from the 21.6% in 2017 to 9.3% in 2025. It's easy to look at that high growth so many years out and think it's crazy, but if you believe in the high level thesis (automated, low cost producer will win the day) their growth runway is very long. For reference, this would result in 1,226,000 accounts in 2025 (up from ~436,000 in July 2017).
2. Average commission per cleared order steps down from $3.99 seen so far in 2017 to $3.45 and remains there. Hedge fund clients increase this number, but introducing brokers bring this number down and that segment has seen higher growth as of late.
3. Trades per day per client moves down in step with average commission per cleared order and for the same reason (introducing broker clients are less active than direct clients). It's worth noting that if they get the hedge fund ball rolling (moving upmarket in hedge fund size) these two assumptions will be far too conservative. On the last call, Peterffy said he expects this number to continue to decrease, but as a slower pace than in years past.
4. The benchmark interest rate continues to increase up to 2.5% and remains there.
5. Borrowing rates for their clients (margin loans) remain in the same range as they have been the past five years.
6. $20 million in credit losses every year. This is a normalized number from past years.
7. $20 million tax benefit related to the IPO structure each year until 2022 (15 years from the IPO) and then nothing after. If my understanding of the tax receivable agreement is correct, this is conservative but on a small scale (by a couple million or less in the out years) so it's not worth including.
8. 1% share dilution per year (which is higher than any year in recent past).
9. 22.5x terminal multiple.
10. 11% discount rate.

That spits out a value of $48.36. As discussed in the write-up, I do believe they can move upmarket in the hedge fund world. They already dominate the small fund space and I think that core niche will allow them to slowly attract larger funds. I've tried to be conservative in my discounted cash flow, but if their prime broker business eventually takes off, my assumptions should look conservative in the rear view mirror. As mentioned before, the stock market is currently as stable as it has been in many decades, so volatility returning to historical levels is a free option as well. Finally, a US tax cut to 25% would also immediately add around $3 of value to the company.

High level thoughts

While the financials and a lot of nitty gritty details are important to an investment thesis, I'm always reminding myself not to lose sight of the forest by looking at the trees. First and foremost, I'm not sure how the brokerage industry will pan out 10-20 years down the line, but if I'm making a bet right now (and I am) it's going to be on the company that is the low cost provider, is the most automated, and has the fewest conflicts of interest with its own customers.

Interactive Brokers is tiny in the world of $100 million dollar hedge funds and larger. And while there's surely not enough borrow availability for a $10 billion dollar fund to use Interactive Brokers, with a lot of <$50 million dollar funds moving to them thanks to the pricing and execution advantage and regulations like Basel 3, their borrow availability will continue to improve for funds in the couple hundred million range. As some of those move over, the borrow will improve for funds around that $1 billion mark and on and on. Plus, the longer they're public and the larger their float becomes, the more known they'll become and thus more funds will consider them as a prime broker.

Of course none of that is guaranteed, but when I think of the brokerage business twenty years from now, it's hard to imagine more money not being invested where there are the fewest frictional expenses, and that is where the best technology has ousted the unnecessary overhead.